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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 62

ELECTRO-CHEMICAL ENGRAVING CO., INC.,
PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED MAY 1, 1940.

CERTIORARI GRANTED JUNE 3, 1940.

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SUPREME COURT OF THE UNITED STATES

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COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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[fol. 1]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 89121

ELECTRO-CHEMICAL ENGRAVING CO., INC., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances:

For Petitioner: Barnard S. Barron, Esq.
For Respondent: Walt Mandry, Esq.

DOCKET ENTRIES

1937

May 19. Petition received and filed. Taxpayer notified. (Fee paid.)
May 19. Copy of petition served on General Counsel.
June 15. Answer filed by General Counsel.
June 17. Copy of answer served on taxpayer.
Nov. 27. Notice issued placing proceeding on New York City Calendar.

1938

Oct. 20. Hearing set week of 12/5/38, New York, N. Y.
Dec. 5. Hearing had before Mr. Disney on merits. Submitted. Stipulation of facts filed. Petitioner's brief due 12/10/38—respondent's brief due over 1/10/39—reply due 1/25/39.

[fol. 2]

Dec. 9. Brief filed by taxpayer. 12/9/38 copy served.
Dec. 21. Transcript of hearing 12/5/38 filed.

1939

Jan. 30. Motion for leave to file brief filed by General Counsel—brief lodged. 1/30/39 granted.
Jan. 27. Reply memorandum filed by taxpayer. 1/31/39 copy served.
Apr. 24. Memorandum opinion rendered—Mr. Disney, Division 4. Decision will be entered under Rule 50.
May 22. Computation of deficiency filed by General Counsel.
May 24. Hearing set June 14, 1939 on settlement.
May 26. Consent to settlement filed by taxpayer.
June 6. Decision entered—Charles P. Smith, Division 5.

Aug. 28. Petition for review by U. S. Circuit Court of Appeals, Second Circuit, with assignments of error filed by Commissioner.

Sept. 6. Proof of service filed by Commissioner (2)—taxpayer and counsel.

Oct. 6. Praecipe for record filed by Commissioner—proof of service thereon.

[fol. 3] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket #89121

PETITION—Filed May 19, 1937

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau Symbols IT:A:4:LGS-90D), dated March 15, 1937 and as a basis for its proceeding, alleges as follows:

First. That petitioner is a corporation duly organized and existing under and by virtue of the laws of the State of New York, with its principal office at 1100 Brook Avenue, in the Borough of Bronx, City and State of New York.

Second. Upon information and belief, that the notice of deficiency (copy of which is attached hereto and marked Exhibit "A") was mailed to petitioner on or about March 15, 1937.

Third. That the taxes in controversy are income and excess profits taxes for the calendar year 1935. The deficiencies asserted are as follows:

Income taxes	$14,035.71
Excess Profits taxes	2,547.07
	$16,582.78

[fol. 4] and that $13,623.14 of the deficiency asserted for income taxes and the full amount, $2547.07, of the deficiency asserted for excess profits taxes are in controversy.

Fourth: That the determination of the taxes set forth in said notice of deficiency is erroneous in the following respects:

(a) In determining the taxable net income of the petitioner for the year 1935, the Commissioner erroneously limited to $2,000 and erroneously disallowed the balance of a deduction representing a loss to petitioner resulting from the foreclosure of a mortgage covering certain real property owned by the taxpayer in the State of New York and the consequent abandonment of said property by petitioner. The Commissioner contends that such loss arises from the sale or exchange of capital assets and is deductible only to the extent of $2,000.

(b) In determining the taxable net income of the taxpayer for the year 1935, the Commissioner erroneously included as income of the petitioner various amounts representing accruals in prior years for taxes, interest on unpaid taxes and interest on a mortgage payable, and erroneously disallowed as a deduction an amount representing similar accruals in the year 1935, all of which accruals (aggregating $12,009.17) related to the real property above referred to. The Commissioner contends that petitioner's liability for such accruals ceased to exist on foreclosure of the mortgage above referred to, and constituted income in 1935 as to prior years' accruals and were not deductible as to 1935 accruals.

(c) By reason of the errors set forth in (a) and (b) above, the Commissioner erroneously computed excess profits taxes of the petitioner in the sum of $2547.07.

[fol. 5] Fifth. That the facts upon which petitioner relies as a basis for this proceeding are as follows:

A. As to the determination referred to in "Fourth (a)":

1. During the year 1935 and for several years prior thereto, petitioner was the owner of certain real property located in the Village of College Point, Town of Flushing, County of Queens, State of New York.

2. As at December 31, 1934 the cost of said real property to petitioner, after deducting the amount of a mortgage thereagainst and the adjusted amount of depreciation, was the sum of $101,352.26.

3. In or about the month of March 1935, judgment was rendered in an action in the Supreme Court of the State of New York brought by the holder of the aforementioned mortgage to foreclose said mortgage; and pursuant to said

judgment, a deed conveying title to said premises was executed and delivered by the referee in foreclosure, appointed by said court, to the purchaser on foreclosure.

4. At the time of such judgment of foreclosure and sale and consequent thereupon, petitioner fully and completely abandoned said real property.

5. As at the time of said foreclosure and sale and the consequent abandonment of said real property, the cost thereof to petitioner, after deducting the amount of the aforesaid mortgage thereagainst and the adjusted amount of depreciation, was the sum of $101,077.44.

6. By reason of the foregoing, petitioner suffered a deductible loss of $101,077.44, subject, however, to recoupment [fol. 6] to the extent of $12,009.17 for accrued real estate taxes, interest on taxes and interest on mortgage payable, leaving a net deductible loss to petitioner of $89,068.27.

7. Such loss was sustained during the year 1935 as aforesaid and was not compensated for by insurance or otherwise.

8. Taxable capital gains of petitioner reported during the calendar year 1935 amounted to $979.82.

B. As to the determination referred to in "Fourth (b)":

9. In its returns for the calendar years 1932, 1933 and 1934, petitioner deducted from its income for said years, respectively, the amount of various accruals for real estate taxes, interest on unpaid taxes and interest on mortgage payable; and in its return for the year 1935, petitioner deducted from its income for said year further amounts representing similar accruals for part of said year.

10. The total of said accruals for all of said years, including the part of the year 1935, aggregated $12,009.17; and all of said accruals related to the real property of petitioner hereinabove referred to.

11. Petitioner's liability for such accruals ceased to exist on foreclosure solely by reason of the fact that by such foreclosure petitioner, in effect, actually paid all of such accruals.

12. The termination on foreclosure and abandonment of petitioner's obligation for such accruals did not constitute [fol. 7] income but a partial return to petitioner of its cost of said real property.

C. As to the determination referred to in "Fourth (c)":

13. By reason of the errors of the Commissioner above set forth, a deficiency is asserted for excess profits taxes amounting to $2,547.07. The facts above set forth by petitioner, if sustained, eliminate liability for such taxes.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine that the deficiency due from petitioner for the year 1935 should not be in excess of $412.57.

(Sgd.) Bernard S. Barron, Attorney for Petitioner,
10 East 40th Street, New York, N. Y.

Attorneys: Barron, Rice & Rockmore, 10 East 40th Street, New York, N. Y.

[fol. 8] *Duly sworn to by Milton C. Jacober. Jurat omitted in printing.*

[fol. 9] EXHIBIT "A" ANNEXED TO PETITION

SN-R.

Treasury Department, Washington

Office of Commissioner of Internal Revenue

Address Reply to Commissioner of Internal Revenue And Refer to —.

March 15, 1937.

Electro-Chemical-Engraving Co., Inc., 1100 Brook Avenue, New York, New York.

SIRS:

You are advised that the determination of your income tax liability for the taxable year(s) 1935 discloses a deficiency of $14,035.71 and that the determination of your ex-

cess-profits tax liability for the year(s) mentioned discloses a deficiency of $2,547.08 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1934, notice is hereby given of the deficiencies mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies above stated.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commis- [fol. 10] sioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, (Signed) Guy T. Helvering, Commissioner, by Chas. T. Russell, Deputy Commissioner.

Enclosures: Statement. Form 870. Schedules.

[fol. 11] Statement

IT:A:4.
LGS-90D.

In re Electro-Chemical Engraving Co., Inc., 1100 Brook Avenue, New York, New York

Tax Liability for Taxable Year 1935

	Liability	Assessed	Deficiency
Income Tax	$15,147.33	$1,111.62	$14,035.71
Excess-Profits Tax	$ 2,547.08	None	$ 2,547.07

The deficiency shown herein is based upon the report dated October 24, 1936, prepared by Revenue Agent W. P. Pritzker, a copy of which was transmitted to you. The report has been approved as submitted.

Net Income is disclosed by return		$8,084.49
Add:		
(a) Insurance	$1,468.87	
(b) Capital Stock Tax	203.00	
(c) Accruals	12,009.17	
(d) Foreclosure loss	86,762.21	
(e) Interest on mortgage	2,161.89	
Total	$102,605.14	
Less:		
(f) Depreciation	527.20	
		102,077.94
Net income as adjusted		$110,162.43

[fol. 12] Explanation of Changes

(a) Unabsorbed fire and use occupancy insurance as at December 31, 1935 not deductible in full but is prorated over its term.

(b) Capital stock tax claimed	$1,203.00
1936 capital stock tax accrued July 1, 1935	1,000.00
Excessive deduction disallowed	$203.00

(c) The records disclose that in the year 1935 you lost your College Pt. property. On your books the following accruals were set up in the years stated:

Real Estate Taxes:

1932	$1,781.00
1933	2,728.00
1934	3,113.00
1935	765.05

Interest on unpaid taxes:

1933	225.01
1934	606.55
1935	190.56

Interest on Mortgage:

1934	$2,000.00
1935	600.00
Total	$12,009.17

[fol. 13] In Peabody Coal Company, 18 B. T. A., 1081, it was held that reserves set up and which were allowable deductions, became income in the year in which the reason for which they were created ceases to exist.

The accruals set up by you were allowable deductions in the various years. Liability for the payments ceased to exist in 1935 when the property was lost by foreclosure. It is, therefore, held that the accruals are taxable income in 1935 and not a reduction in the foreclosure loss.

(d) In item (c) above it is held that the unpaid accruals of $12,009.17 represented taxable income and not a reduction of the foreclosure loss. It is also held by this office, that losses from foreclosure sales are losses from capital assets and the losses are limited to $2,000.00. In view of the accruals of $12,009.17 considered to be income, and due to an adjustment of the depreciation, the foreclosure loss is computed as follows:

Cost of property		$156,764.51
Less: Depreciation	$15,687.07	
Mortgage	40,000.00	55,687.07
Foreclosure loss (limited to $2000.00)		$101,077.44
Foreclosure loss claimed $88,762.21 less $ 2,000.00	=	$86,762.21

(e) Interest on mortgage, $2,161.89, which you claimed as a deduction in 1935 represents an incurred interest expense in 1934 and is, therefore, disallowed as a deduction in computing taxable income for the year 1935.

[fol. 14] (f) Depreciation has been adjusted in accordance with Treasury Decision 4422.

	Taken	Allowed
Machinery & Factory Fixtures	$19,514.06	$19,980.40
Office Furn. & Fixtures	1,196.80	1,300.50
Buildings—Bronx, N. Y.	8,568.73	8,559.89
Buildings—Brooklyn, N. Y.	427.82	427.82
Buildings—College Pt.	308.82	274.82
Automobiles	415.40	415.40
	$30,431.63	$30,958.83
Additional allowable	527.20	
	$30,958.83	$30,958.83

See attached depreciation schedules

Computation of Tax

Net income	$110,162.43
Income tax at 13¾%	$ 15,147.33
Corrected income tax liability	$ 15,147.33
Income tax assessed, original, account #402113	$ 1,111.62
Deficiency in income tax	$ 14,035.71
Net income for excess-profits tax computation [fol. 15]	$110,162.43
Less: 12½% of $473,766.78 value of capital stock as declared in your capital stock tax return for year ended June 30, 1935	59,220.85
Amount subject to excess-profits tax	$ 50,941.58
Excess-profits tax 5% of $50,941.58	$ 2,547.08
Excess-profits tax assessed, original, account #402113	None
Deficiency in excess-profits tax	$ 2,547.08

The records of this office indicate that no reply has been received to letter dated January 22, 1937 advising you of the approval of the report submitted by the Internal Revenue agent in charge, 341 Ninth Avenue, New York, New York, a copy of which was transmitted to you.

[fol. 16] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 89121

[File endorsement omitted.]

ANSWER—Filed June 15, 1937

Now comes the respondent, by his attorney Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition of the above-named taxpayer admits and denies as follows:

First. Admits the allegations contained in paragraph First of petition.

Second. Admits the allegations contained in paragraph Second of petition.

Third. Admits the taxes in controversy are income and excess profits taxes for the calendar year 1933 and that the deficiencies proposed are the amounts alleged in paragraph Third of petition. Denies the remainder of the allegations contained in paragraph Third of petition.

Fourth. (a) Denies the Commissioner erred in respect to the matters set forth in sub-paragraph (a) of paragraph Fourth. Admits the allegations set forth in the last sentence of sub-paragraph (a) of paragraph Fourth of petition.

(b) Denies the Commissioner erred in respect to the matters set forth in sub-paragraph (b) of paragraph Fourth. Admits the allegations set forth in the last sentence of sub-paragraph (b) of paragraph Fourth of petition.

[fol. 17] (c) Denies the Commissioner erred in respect to the matters set forth in sub-paragraph (c) of paragraph Fourth of petition.

Fifth. A-1, 2, 3. Admits the allegations contained in sub-paragraphs A-1, 2, 3, of paragraph Fifth of petition.

A-4, 5, 6, 7, 8. Denies the allegations contained in sub-paragraphs A-4 to 8, inclusive, of paragraph Fifth of petition.

B-9, 10. Admits the allegations contained in sub-paragraphs B-9 and 10 of paragraph Fifth of petition.

B-11, 12. Denies the allegations contained in sub-paragraphs B-11 and 12 of paragraph Fifth of petition.

C-13. Denies the allegations contained in sub-paragraph C-13 of paragraph Fifth of petition.

Denies generally and specifically each and every allegation contained in taxpayer's petition, not hereinbefore admitted, qualified or denied.

Wherefore it is prayed that taxpayer's appeal be denied.

(Signed) Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: J. E. Marshall, C. R. Marshall, Special Attorneys, Bureau of Internal Revenue.

[fol. 18] BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 89121

Bernard S. Barron, Esq., for the petitioner.

E. O. Hanson, Esq., and Walt Mandry, Esq., for the respondent.

MEMORANDUM OPINION

DISNEY:

This proceeding involves taxes for the calendar year 1935, the Commissioner having determined deficiency in income taxes of $14,035.71 and excess profits tax of $2,547.07. The facts are stipulated, and will be set forth herein only so far as necessary to consideration of the issues presented. Three questions are presented: (a) Is a mortgagor's loss from judicial foreclosure of a mortgage on real estate subject to limitation under section 117 (d) of the Revenue Act of 1934?; (b) Are accrued taxes and interest as to the foreclosed property allowed in earlier years, now barred by limitations, taxable income in the year of foreclosure?; (c) May petitioner deduct taxes and interest, in the year of the foreclosure which relieves him of payment thereof?

As to the first question, that of limitation on capital loss, there seems no necessity for extended discussion, since the decisions in Commissioner v. Freihofer, et al., — Fed. (2d) — (March 15, 1939), (affirming Sol Greisler, 37 B. T. A. 542); Lloyd Jones, 39 B. T. A. — (No. 69, March 7, 1939); H. L. Rust, Jr., 38 B. T. A. 910, in all of which it has been held that a foreclosure sale is not a sale or exchange within the purview of section 117 (d) of the Revenue Act of 1934.

[fol. 19] We find no difference therein material to the issue, and therefore hold that petitioner's loss was not subject to the limitation under said statute.

As to the second question; Petitioner claimed a loss of $100,771.38, subject to recoupment of $10,453.56 because, being on the accrual basis of accounting, petitioner had accrued, and had been allowed, $10,453.56 as accrued but unpaid taxes and interest in previous years. Respondent contends that the amount, accrued in previous years now barred by limitation statutes, having never been paid, became income in 1935 when the real estate as to which the amounts were accrued was sold under foreclosure and liability for the items ceased. By his treatment of the accruals as deductible from its loss, petitioner seems to agree that in the taxable year liability ceased as to the accrued interest and taxes. Petitioner contends that if that view be taken, the loss is increased in the same amount, since it was reduced only by consideration of the accrual of interest and taxes in former years. The petitioner is clearly correct. He had a loss, if the accrued interest and taxes are not considered, of $100,771.38, representing purchase price plus capital expenditure on the property, less stipulated depreciation allowed and purchase-money mortgage unpaid. That amount is consistent with respondent's computation of loss. Petitioner did not, in fact, pay the taxes or interest, and deducted them from the loss only because of the accrual method used in accounting. To deduct these amounts from loss, and then add them to income, would obviously be to consider them twice. The respondent is correct in adding the amounts accrued to income. Peabody Coal Co., 18 B. T. A. 1081; Chicago, Rock Island & Pacific Ry. Co., 13 B. T. A. 988; affd., 47 Fed. (2d) 990; Charleston & Western Carolina Ry. Co., 17 B. T. A. 569; affd., 50 Fed. (2d) 342; [fol. 20] but the petitioner was in error in deducting the accruals from the actual loss. We therefore, having above held that the loss was not capital loss and therefore not limited by the statute, consider the loss claimed as $100,771.38 and allow same in full, and at the same time approve the action of the respondent in adding the accruals to income for the year 1935.

As to the third question, involving further accruals for interest and taxes for the year 1935: We perceive no distinction between this situation involving $1,155.61, and that

as to the previous years. The action of the respondent in adding such accruals to income is therefore approved.

Decision will be entered under Rule 50.

Entered Apr. 24, 1939.

[fol. 21] BEFORE UNITED STATES BOARD OF TAX APPEALS, WASHINGTON

Docket No. 89121

DECISION

The respondent on May 22, 1939, having filed computation under Rule 50, pursuant to the Memorandum Opinion of the Board entered April 24, 1939, and the petitioner having acquiesced therein, it is

Ordered and Decided: That there is a deficiency in income tax in the amount of $454.65, and no deficiency in excess-profits tax, for the year 1935.

(Signed) Charles P. Smith, Member.

Entered Jun. 6, 1939.

[fol. 22] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

B. T. A. Docket No. 89121

GUY T. HELVERING, Commissioner of Internal Revenue, Petitioner on Review,

v.

ELECTRO-CHEMICAL ENGRAVING CO., INC., Respondent on Review

[File endorsement omitted.]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR—Filed August 28, 1939

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

Now Comes the Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney Gen-

eral, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and John M. Morawski, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I

Jurisdiction

The petitioner on review (hereinafter referred to as the Commissioner), is the duly appointed, qualified and acting [fol. 23] Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

The respondent on review, Electro-Chemical Engraving Company, Inc., (hereinafter referred to as the taxpayer), is a corporation organized under the laws of the State of New York, with its principal office located at 1100 Brook Avenue, in the Borough of Bronx, City and State of New York. Electro-Chemical Engraving Company, Inc., filed its income and excess-profits tax return for the calendar year 1935 with the Collector of Internal Revenue for the Third District of New York and within the judicial circuit of the United States Circuit Court of Appeals for the Second Circuit.

II

Prior Proceedings

On March 15, 1937, the Commissioner determined a deficiency in income tax for the year 1935 in the amount of $14,035.71 and a deficiency in excess-profits tax for the year 1935 in the amount of $2,547.08, and sent by registered mail a notice of said deficiency in accordance with the provisions of Section 272 of the Revenue Act of 1934. Thereafter, and on May 19, 1937, the taxpayer filed a petition for a redetermination of said deficiencies by the United States Board of Tax Appeals.

The case was tried before the Board of Tax Appeals on December 5, 1938, at New York, New York.

On April 24, 1939, the Board entered its Memorandum Opinion, and on June 6, 1939, entered its decision, wherein it was ordered and decided that there is a deficiency in income tax in the amount of $454.65 and no deficiency in excess-profits tax for the year 1935.

[fol. 24]

III

Nature of Controversy

The question presented was whether the mortgagor's loss resulting from a sale of the mortgaged property pursuant to foreclosure proceedings, is subject to the limitation of Section 117(d) of the Revenue Act of 1934.

The taxpayer acquired certain real estate with improvements thereon, in 1927 for $150,000.00. It assumed a first mortgage of $20,000.00 which was subsequently paid off in full, and executed a purchase money bond for $80,000.00, subsequently reduced to $40,000.00, secured by a mortgage on the property. The property was sold at foreclosure sale during the taxable year for less than the principal due on the existing mortgage, and the taxpayer sustained a loss of $100,771.38. The proceeds of the sale were applied to a partial satisfaction of the indebtedness, and the mortgagee did not apply for a deficiency judgment against the taxpayer.

The Commissioner contended that the loss was sustained "upon the sale" of taxpayer's property within the meaning of Section 117 of the Revenue Act of 1934 and accordingly was limited to $2,000.00 by the provisions of Section 117(d) thereof. The Board, however, held that the loss was deductible in its entirety and not limited by the provisions of said Section 117.

IV

Assignments of Error

The Commissioner avers that in the record and proceedings before the Board of Tax Appeals and in the opinion and final decision rendered and entered by the Board of Tax [fol. 25] Appeals, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceeding, opinion and final decision so rendered and entered by the Board of Tax Appeals:

1. The Board of Tax Appeals erred in holding and deciding that there is a deficiency in income tax in the amount of $454.65 and no deficiency in excess-profits tax for the year 1935.

2. The Board of Tax Appeals erred in failing to hold and decide that there is a deficiency in income tax in the amount of $14,035.71 and a deficiency in excess-profits tax in the amount of $2,547.08 for the year 1935.

3. The Board of Tax Appeals erred in deciding, as a matter of law, that the sale of taxpayer's property pursuant to an action of foreclosure was not a "sale or exchange" within the meaning of Section 117 of the Revenue Act of 1934 and therefore erred in concluding that the taxpayer was entitled to deduct the loss suffered as an ordinary loss rather than a capital loss.

4. The Board of Tax Appeals erred in holding and deciding for the taxpayer.

5. The Board of Tax Appeals erred in that its decision is not supported by the evidence and is contrary to law.

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit, that a transcript of the record be prepared in accordance with [fol. 26] law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Sgd.) Samuel O. Clark, Jr. R., Assistant Attorney General, Signed J. P. Wenchel R., (Sgd.) J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: John M. Morawski, Special Attorney, Bureau of Internal Revenue.

[fol. 27] *Duly sworn to by John M. Morawski. Jurat omitted in printing.*

[fol. 28] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

B. T. A. Docket No. 89121

[File endorsement omitted]

NOTICE OF FILING PETITION FOR REVIEW—Filed September 6, 1939

To: Electro-Chemical Engraving Company, Inc., 1100 Brook Avenue, New York, New York.

You are hereby notified that the Commissioner of Internal Revenue did, on the 28th day of August, 1939, file with

the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Signed J. P. Wenchel, R., Chief Counsel, Bureau of Internal Revenue.

[fol. 29] Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 30 day of August, 1939.

Electro-Chemical Engraving Co., Inc., (Sgd.) M. C. Jacober, Vice. Pres. & Treas., Respondent on Review.

spt 8-21-39.

[fol. 30] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

B. T. A. Docket No. 89121

[File endorsement omitted]

NOTICE OF FILING PETITION FOR REVIEW—Filed September 6, 1939

To: Bernard S. Barron, Esq., 10 East 40th Street, New York, N. Y.

You are hereby notified that the Commissioner of Internal Revenue did, on the 28th day of August, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Signed J. P. Wenchel, R., Chief Counsel, Bureau of Internal Revenue.

[fol. 31] Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 30 day of August, 1939.

(Sgd.) B. S. Barron, Attorney for Respondent on Review.

spt 8-21-39.

[fol. 32] Before United States Board of Tax Appeals

Docket No. 89121

[Title omitted]

[File endorsement omitted]

Stipulation of Facts—Filed December 5, 1938

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken to be true, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true:

1. The petitioner is a corporation organized under the laws of the State of New York with its principal office at 1100 Brook Avenue, Bronx, New York.

2. On March 1, 1927, the petitioner purchased from the Hadley Realty Company, for factory business use, certain real estate with improvements thereon, located in the Village of College Point, Town of Flushing, County of Queens, State of New York, for a consideration of $150,000.00. The [fol. 33] purchaser paid $50,000. in cash, assumed an existing first mortgage indebtedness of $20,000.00, executed a purchase money bond in the sum of $80,000.00 to Hadley Realty Company bearing interest at the rate of 6% per annum, which indebtedness was secured by a purchase money mortgage on the property, (copies of the bond and mortgage being annexed hereto as exhibits "A" and "B", respectively).

3. On May 19, 1927, the purchase money bond and mortgage were assigned to Bernard Weinbaum.

4. On or about March 14, 1930 the petitioner paid the first mortgage indebtedness of $20,000.00.

5. Petitioner defaulted (a) in the payment of the sum of $4,000.00 required to be paid on September 1st, 1932, in reduction of the principal of the aforesaid purchase money mortgage mentioned in paragraph "2" hereof, and in the payment of all subsequent semi-annual installments of principal; (b) in the payment of the semi-annual installment of interest required to be paid on September 1st, 1934 under said purchase money mortgage and in the payment of all subsequent semi-annual installments of interest; and (c) in the payment of real estate taxes for the second half of the year 1932 required to be paid to the City of New York on or before November 30th, 1932, and in the payment of all subsequent real estate taxes.

6. In December, 1934, Bernard Weinbaum, owner and holder of the aforesaid purchase money mortgage, because of the defaults above mentioned, brought an action against the petitioner in the Supreme Court of the State of New York, County of Queens, for the foreclosure thereof. The petitioner herein was served with summons and complaint [fol. 34] in said action and duly appeared therein. On or about February 6, 1935, a judgment of foreclosure and sale was duly entered in said action, awarding a judgment in favor of Bernard Weinbaum and against the petitioner, in the amount of $50,594.72, consisting of the sum of $40,000.00 representing the unpaid principal of the mortgage debt, interest thereon of $2100.00, and unpaid real estate taxes and penalties thereon in the amount of $8,494.72 (a copy of which judgment is annexed hereto as exhibit "C").

7. Pursuant to the aforesaid judgment of foreclosure and sale, the Referee appointed in said action by order of the Court sold, the mortgaged premises on March 7, 1935, to one Simon Bergman for the sum of $21,000.00, subject to all unpaid taxes, assessments and water charges, then a lien against said premises, and on March 22, 1935, said Referee, pursuant to judgment entered, executed a deed, to which the necessary Federal revenue stamps were affixed, whereby title to said premises was conveyed to said Simon Bergman, a person unknown to petitioner. (Copy of the deed is annexed hereto as exhibit "D").

8. By reason of said judgment of foreclosure and sale (February 6, 1935) petitioner was foreclosed and barred of

all right, title, interest and equity of redemption in the aforesaid premises.

9. The said referee received the proceeds of sale, namely $21,000.00, and after paying certain incidental costs, applied the sum of $20,166.39 toward the satisfaction of the debt of $50,594.72 due said Bernard Weinbaum, leaving a deficiency in the sum of $30,428.33. Said Bernard Weinbaum has never sought to avail himself of the provisions [fol. 35] of Section 1083A of the New York Civil Practice Act to enforce such deficiency against the petitioner.

10. The petitioner's basis for determining gain or loss from the said property should be adjusted for (a) capital expenditures in the amount of $6,764.51 and (b) depreciation allowed in the amount of $15,687.07.

11. The petitioner is on the accrual basis and in its returns for the years 1932, 1933 and 1934, which are now barred by the Statute of Limitations, claimed and was allowed deductions for real estate taxes and penalties on the foreclosed property and interest on the mortgage debt thereon in the following amounts:

Accrued but unpaid real estate taxes and penalties	1932	$1,781.00
Accrued but unpaid real estate taxes and penalties	1933	2,953.01
Accrued but unpaid real estate taxes and penalties	1934	3,719.55
Accrued but unpaid interest on mortgage	1934	2,000.00
Total Accruals		$10,453.56

The petitioner also claimed in its return for 1935 similar deductions in the following amounts:

Accrued but unpaid real estate taxes and penalties	1935	$955.61
Accrued but unpaid interest on mortgage	1935	600.00
Total Accruals		$1,555.61

[fol. 36] The total of all the above accruals amount to the sum of $12,009.17.

12. The petitioner in its return for the year 1935 claimed a loss of $88,762.21 on the said property computed as follows:

Cost of Property (Land & Building)		$156,764.51
Less:		
Accrued for taxes and interest not paid	$12,009.17	
Mortgage payable	40,000.00	
Reserve for depreciation	15,993.13	68,002.30
Net Loss		$88,762.21

13. In the notice of deficiency, the Commissioner added to income the accrued taxes and interest in the amount of $12,009.17 referred to in paragraph 11 of this stipulation, and disallowed the amount of $86,762.21 of the claimed loss referred to in paragraph 12 of this stipulation.

B. S. Barron, Counsel for Petitioner; J. P. Wenchel, ECA, Chief Counsel, Bureau of Internal Revenue.

[fol. 37] EXHIBIT "A" ANNEXED TO STIPULATION

Know All Men by These Presents, That Electro Chemical Engraving Company, a corporation organized under the laws of the State of New York, whose principal office and place of business is located at 52 Vanderbilt Avenue, in the Borough of Manhattan, City, County and State of New York, hereinafter designated as the obligor does hereby acknowledge itself to be justly indebted to Hadley Realty Company, Inc., a corporation organized under the laws of the State of New York, whose principal office and place of business is located at 120 Broadway, in the Borough of Manhattan, City, County and State of New York, hereinafter designated as the obligee, in the sum of Eighty Thousand Dollars ($80,000.00)—Dollars, lawful money of the United States, which sum the said obligor does hereby covenant to pay the said obligee, its successors or assigns, in instalments as follows, viz.:—

Four thousand Dollars ($4,000.00) thereof upon September 1, 1927.

Four thousand Dollars ($4,000.00) semi-annually thereafter upon the first days of March and September until fully paid, and the interest upon the whole sum, or upon so much thereof as shall remain unpaid, to be computed from the first day of March, 1927, at and after the rate of six (6) per centum per annum, and to be paid on the first day of September, next ensuing and semi-annually thereafter.

The Obligor, its successors or assigns, shall have the right upon ninety (90) days' written notice to the Obligee, its successors and assigns, to anticipate the payment of any part or all of the indebtedness hereinabove referred to.

It is Hereby Expressly Agreed, that the said principal sum shall become due at the option of the said obligee, or [fol. 38] the successors or assigns of the obligee, after default in the payment of interest for 30 days, or after default in the payment of any taxes, assessments or water rates for sixty days after notice and demand, or after default in the payment of any instalment of principal, or after any other default, or upon the happening of any event by which, in any case, under the terms of the mortgage securing this bond, the said principal sum may or shall become due and payable; also that all of the covenants and agreements made by the said obligor in said mortgage are hereby made part of this instrument.

Signed and sealed this first day of March, 1927.

Electro Chemical Engraving Company, by F. E. Switzer, President.

In the presence of:

Attest: N. L. Jacobis, Secty.

[fol. 39] State of New York,
County of New York, ss:

On this 1st day of March, in the year one thousand nine hundred and twenty-seven, before me personally came Frederick E. Switzer, to me known, who, being by me duly sworn, did depose and say, that he resides in ——; that he is the President of Electro Chemical Engraving Company, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of

Directors of said corporation, and that he signed his name thereto by like order.

Herbert Peterson, Notary Public Queens Co., Queens Co. Clk's No. 4973, N. Y. Co. Clk's No. 485, Reg's. No. 7361: Commission exp. March 30, 1927.

[fol. 40] EXHIBIT "B" ANNEXED TO STIPULATION

This Mortgage, made the 1st day of March, nineteen hundred and twenty-seven.

Between Electro Chemical Engraving Company, a corporation organized under the laws of the State of New York, whose principal office and place of business is located at No. 440 to 458—19th Street, in the Borough of Kings, City, County and State of New York, the mortgagor, and Hadley Realty Company, Inc., a corporation organized under the laws of the State of New York, whose principal office and place of business is located at No. 120 Broadway, in the Borough of Manhattan, City, County and State of New York, the mortgagee.

Witnesseth, that to secure the payment of an indebtedness in the sum of Eighty Thousand Dollars ($80,000.00) *Dollars,* lawful money of the United States, to be paid in instalments, as follows, viz.:

Four thousand Dollars ($4,000.00) thereof upon September 1, 1927.

Four thousand Dollars ($4,000.00) semi-annually thereafter upon the first days of March and September until fully paid.

With interest at six per cent upon the amount unpaid, payable September 1, 1927 and semi-annually thereafter, according to a certain bond or obligation bearing even date herewith, the mortgagor hereby mortgages to the mortgagee

1. All those certain lots, pieces or parcels of land, situate, lying and being in the City of New York, Borough of Queens (late Village of College Point, Town of Flushing) County of Queens and State of New York and designated as lots numbers 39, 41, 43, 45, 47, 49, 51, 53, 55, 57, 59, 61, 63, 65, 67, 69, 71, 2, 56, 54, 52, 50, 48, 121, 123, 125, 127, 129, 131, 133 [fol. 41] in Block 45 on map of the Village of College Point, according to the Town Assessment Map of the Town of

Flushing, Queens County, New York, and which said lots taken together are bounded and described as follows:

Beginning at a point formed by the intersection of the Southerly line or side of Third Avenue with the Westerly line or side of Tenth Street; running thence westerly along the Southerly line or side of Third Avenue 444 feet, more or less, to the Easterly line or side of Eighth Street; thence Southerly along said Easterly line or side of Eighth Street 197 feet, more or less, to the Northerly line of lot number 1 on said map; thence Northeasterly and along lot number 1 on said map 101 feet 6 inches, more or less, to lot number 2 on said map; thence Southerly on the line dividing said lots numbers 1 and 2 on said map 75 feet 11¼ inches, more or less to the Northerly line or side of Fourth Avenue; thence Easterly along said Northerly line or side of Fourth Avenue 318 feet, more or less, to the Northwesterly corner of Fourth Avenue and Tenth Street, and thence Northerly along the Westerly line or side of Tenth Street 268 feet, more or less, to the point or place of beginning.

2. All the right, title and interest of the Mortgagor in and to that certain lot of land situate in the Borough of Queens (formerly Village of College Point, in the Town of Flushing) of the City of New York, in the County of Queens and State of New York, and formerly designated as Lot No. 1 in Block 45 on Map of Village of College Point, according to the town assessment map of the Town of Flushing, Queens County, New York, and which said lot according to a survey thereof made by Leonard C. L. Smith, City Surveyor, dated July 1st, 1915 is particularly bounded and described as follows:

[fol. 42] Beginning at the Northeasterly corner of Eighth Street and Fourth Avenue and running thence Easterly along the Northerly side of Fourth Avenue 100 feet 10 inches, more or less, to Lot No. 2 on said map; thence Northerly along said Westerly side of said Lot No. 2, 75 feet 11¼ inches, more or less; thence Southwesterly 102.43 feet, more or less, along the Northerly line of said Lot No. 1, to the Easterly side of Eighth Street and thence Southerly along the Easterly side of Eighth Street 50.14 feet to the point of beginning.

Subject However, to a prior mortgage made by the Mortgagee dated March 3, 1916, and recorded in the office of the

County Clerk of Queens County in Liber 1667, Section 16, Block 3951 of Mortgages, at page 428, upon which there remains unpaid the sum of $20,000 and interest at the rate provided in the said mortgage, the payment of said mortgage having been extended by an Extension Agreement dated June 26, 1925 between the Mortgagee and Home Life Insurance Company, said extension agreement providing for the payment of $2,500 on March 3, 1926 and annually thereafter, and for the payment of the unpaid balance thereof on March 3, 1930.

This mortgage being a purchase money mortgage given to secure a portion of the purchase price mentioned in a certain Deed from the Mortgagee to the Mortgagor delivered and intended to be recorded simultaneously herewith.

The mortgagor, its successors or assigns, shall have the right upon ninety (90) days' written notice to the Mortgagee, its successors and assigns, to anticipate the payment of any part or all of the indebtedness hereinabove referred to.

And the mortgagor covenants with the mortgagee as follows:

1. That the mortgagor will pay the indebtedness as hereinbefore provided.

[fol. 43] 2. That the mortgagor will keep the buildings on the premises insured against loss by fire for the benefit of the mortgagee.

3. That no building on the premises shall be removed or demolished without the consent of the mortgagee.

4. That the whole of said principal sum shall become due after default in the payment of any instalment of principal on its due date or of interest for twenty days, or after default in the payment of any tax, water rate or assessment for sixty days after notice and demand.

5. That the holder of this mortgage, in any action to foreclose it, shall be entitled to the appointment of a receiver.

6. That the mortgagor will pay all taxes, assessments or water rates, and in default thereof, the mortgagee may pay the same.

7. That the mortgagor within six days upon request in person or within thirty days upon request by mail will furnish a statement of the amount due on this mortgage.

8. That notice and demand or request may be in writing and may be served in person or by mail.

9. That the mortgagor warrants the title to the premises, except with respect to Parcel numbered 2, hereinabove described.

10. That the whole of said principal sum shall become due at the option of the mortgagee after default for sixty days after notice and demand, in the payment of any instal- [fol. 44] ment of any assessment for local improvements heretofore or hereafter laid, which is or may become payable in annual instalments and which has affected, now affects or hereafter may affect the said premises, notwithstanding that such instalment be not due and payable at the time of such notice and demand.

11. That the whole of said principal sum shall become due at the option of the mortgagee, if the buildings on said premises are not maintained in reasonably good repair or upon the failure of any owner of said premises to comply with the requirement of any department of the State or City of New York, within three months after an order making such requirement has been issued by any said State or City Department.

12. In the event of the passage after the date of this mortgage of any law of the State of New York, deducting from the value of land for the purposes of taxation any lien thereon, or changing in any way the laws for the taxation of mortgages or debts secured by mortgage for state or local purposes, or the manner of the collection of any such taxes, so as to affect this mortgage, the holder of this mortgage and of the debt which it secures, shall have the right to give thirty days' written notice to the owner of the mortgaged premises requiring the payment of the mortgage debt. If such notice be given the said debt shall become due, payable and collectible at the expiration of said thirty days.

13. That in case of a sale, said premises, or so much thereof as may be affected by this mortgage, may be sold in one parcel.

[fol. 45] 14. That the whole of said principal sum shall immediately become due at the option of the mortgagee, if the mortgagor shall assign the rents or any part of the rents of the mortgaged premises without first obtaining the written consent of the mortgagee to such assignment, or upon the actual or threatened demolition or removal of any building erected or to be erected upon said premises.

15. That the whole of said principal sum shall immediately become due at the option of the mortgagee upon any default in keeping the buildings on said premises insured against loss by fire as required by paragraph No. 2 above, or if after application by any holder of this mortgage to two or more fire insurance companies lawfully doing business in the State of New York and issuing policies of fire insurance upon buildings situate in the place where the mortgaged premises are situate, the companies to which such application has been made shall refuse to issue such policies.

16. That the holder of this mortgage in any action to foreclose it, shall be entitled (without notice and without regard to the adequacy of any security for the debt) to the appointment of a receiver of the rents and profits of said premises.

17. That the whole of said principal sum shall immediately become due at the option of the holder of this mortgage after default in the performance of any of the terms, provisions, covenants or agreements contained in any prior mortgage which may be a superior lien upon said premises or should any action be commenced to foreclose any such prior mortgage.

18. That in default be made in the payment of any interest, when due, upon any prior mortgage which may be a superior lien upon said premises and the default continue [fol. 46] for a period of ten days, the holder of this mortgage shall have the right to pay such interest, and the amount so paid with interest thereon may be added to the indebtedness secured hereby, and shall be a lien on said premises and be collected as part of the debt secured by this mortgage, and in the event of any such payment of interest this mortgage and the whole debt secured thereby shall, at the option of the holder thereof, without notice or demand, immediately become due and payable, although the time lim-

ited for the payment thereof may not have expired and the said holder shall have the same rights and remedies as such holder would have if default were made in the payment of the principal sum hereby secured, anything herein or in said bond contained to the contrary notwithstanding.

19. That in the event of any default in paying said principal or interest, the rents and profits of the mortgaged premises are hereby assigned to the holder of this mortgage as further security for the payment of said indebtedness.

In Witness Whereof, this mortgage has been duly executed by the mortgagor.

Electro Chemical Engraving Company, by F. E. Switzer, President.

In presence of:
Attest: N. L. Jacobis, Secty.

[fol. 47] State of New York,
County of New York, ss:

On the 1st day of March, nineteen hundred and twenty-seven, before me personally came Frederick E. Switzer, to me known, who, being by me duly sworn, did depose and say, that he resides in Borough of ——; that he is the President of Electro Chemical Engraving Company, the corporation described in and which executed the foregoing instrument; that he knows the seal of said corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said corporation, and that he signed his name thereto by like order.

Herbert Peterson, Notary Public, Queens County. Queens Co. Clerk's No. 4973. N. Y. Co. Cl'k's No. 485 Reg's. No. 7361. Commission expires March 30, 1927.

[fol. 48] Exhibit "C" Annexed to Stipulation

At a Special Term of the Supreme Court held in and for the County of Queens at the County Court House thereof, Chamber of Commerce Building, Jamaica, Long Island, New York, on the 28th day of January, 1935.

Present: Hon. Burt Jay Humphrey, Justice.

County Clerk's Index No. 7738—1934

BERNARD WEINBAUM, Plaintiff,

against

ELECTRO-CHEMICAL ENGRAVING COMPANY, INC., and THE PEOPLE OF THE STATE OF NEW YORK, Defendants

ORDER CONFIRMING REPORT OF REFEREE AND FINAL JUDGMENT OF SALE

Upon the notice of pendency of action, the summons and complaint, the notice of appearance and affidavits of service, all heretofore filed herein, the order of reference made and entered herein, on the 18th day of December, 1934 with proof of service of copies and notice of entry thereof on the attorney entitled thereto and of all other papers upon which [fol. 49] said order of reference was granted, the reports of said Referee filed herein on the 16th day of January, 1934, the affidavit of Robert M. Bozeman, verified the 18th day of January, 1935, and upon all the proceedings heretofore had herein, and it appearing that this action was brought to foreclose a mortgage in the original principal amount of $80,000 executed by defendant Electro-Chemical Engraving Company, Inc. to Hadley Realty Company, on March 1st, 1927, covering certain premises, more particularly described in the complaint herein, located in the Village of College Point, Town of Flushing, County of Queens, State of New York, on which mortgage there is now due and owing the unpaid principal amount of $40,000 which said mortgage was recorded in the office of the Register of the County of Queens, on the 11th day of March, 1927 in Liber 3073 of Mortgages at page 320 and indexed under Section 16, Block 3951 on the land map of the County of Queens; that said mortgage and the bond secured by the same were duly assigned to plaintiff herein on or about May 19, 1927, by written assignment dated that day and recorded in said Register's office on the 10th day of June, 1927, in L 3140 of Mortgages at page 322; that since said 19th day of May, 1927, plaintiff Bernard Weinbaum has been and now is the owner of said bond and mortgage; that both of the defendants herein were duly served with copies of the summons and complaint and have duly appeared herein and that defendant Electro-Chemical Engraving Co.,

Inc. interposed an answer herein on the 20th day of November, 1934, which answer was stricken out by an order entered herein on the 18th day of December, 1934; that the time for defendant The People of the State of New York, to interpose an answer herein has expired and has not been extended; that neither of the defendants is an infant at law nor an incompetent, nor an absentee; that by order of this [fol. 50] court made and entered on the 18th day of December, 1934, Jonas Himmelforbe, Esq., was appointed Referee to take proof of the facts and circumstances stated in the complaint herein to examine the plaintiff or his agent under oath as to any payments which may have been made on account of the bond and mortgage set forth in the complaint herein, to compute the amount due plaintiff for principal and interest upon said bond and mortgage, all sums owing to plaintiff on account of taxes and water charges on said premises and all other sums due and owing and to become due and owing to plaintiff upon, under or on account of said bond and mortgage, and to examine and report the manner in which and the means by which the mortgaged premises can be sold, and it further appearing that the report of said Referee was duly filed in the office of the Clerk of the County of Queens on the 16th day of January, 1935, that from said report it appears that there was on the date said report was made, due the plaintiff the sum of $50,594.72 representing defaulted principal and interest, real estate taxes and water charges; that the proceedings before said referee and all other proceedings herein have been regular and according to law, and it further appearing that the plaintiff is entitled to a foreclosure sale of the mortgaged property in order to satisfy the sums then due and owing to plaintiff as aforesaid.

Now on reading and filing the notice of motion herein dated January 18, 1935, the proof of service thereof on the party entitled to notice and the affidavit of Robert M. Bozeman verified the 18th day of January, 1935, and said motion having come on to be heard and, after hearing Robert M. Bozeman, Esq., in support of the motion and no one in opposition thereto,

[fol. 51] Now on motion of Chadbourne, Stanchfield & Levy, attorneys for plaintiff herein, it is

Ordered, Adjudged and Decreed that the report of said Referee filed herein on the 16th day of January, 1935, be

and the same hereby is in all respects approved and confirmed and it is further

Ordered, Adjudged and Decreed that the plaintiff is entitled to judgment herein for (1) the sum of $40,000 representing the entire unpaid principal amount of the mortgage debt; (2) the sum of $1,200 representing a semi-annual instalment of interest due and payable on said unpaid principal amount on September 1, 1934; (3) the sum of $900 on account of interest on said unpaid principal amount from September 1, 1934 to January 15, 1935; (4) the sum of $330.45 as interest on said delinquent taxes for the second half of the year 1932; (5) the sum of $12,728 representing real estate taxes for the year 1933; (6) the sum of $363.33 as interest on said delinquent taxes for the year 1933; (7) the sum of $3,113 representing real estate taxes for the year 1934; (8) the sum of $168.44 as interest on said delinquent taxes for the year 1934; and (9) the sum of $10.50 as water rates for the year 1934, thus making a net total of $50,594.72 owing to plaintiff and for which plaintiff is entitled to judgment together with interest thereon from and after January 15, 1935, and together with the sum of $263.80 to be taxed by the Clerk of this Court and hereby adjudged to the plaintiff for costs and disbursements of this action with interest on said sum to the date hereof, and it is further

Ordered, Adjudged and Decreed that the mortgaged premises described in the complaint and as hereinafter described, be sold at public auction as a single parcel at Town [fol. 52] Hall in the Town of Flushing, County of Queens, State of New York by and under the directions of Jonas Himmelforbe, Esq., who is hereby appointed Referee for that purpose; that said Referee gave public notice of the time and place of said sale according to law and the rules and practice of this court by publishing notice of sale in the North Shore Daily Journal; that the plaintiff or any party to this action may become a purchaser at said sale; that the Referee shall execute and deliver to the purchaser or purchasers at said sale or to their assignee by valid assignment in writing, a deed or deeds to the premises sold; that said Referee on receiving the proceeds of the sale, shall forthwith pay therefrom any taxes, assessments and water rates which are liens upon the property sold and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute at the time of sale, as provided by Section 1087 of the Civil Practice Act.

That said Referee shall then deposit the proceeds in the Bank of Manhattan Company and thereof make the following payments and his checks drawn for such purpose shall be paid by said depository:

(1) He shall pay a sum not to exceed the sum of $100 to the said Referee for his fees herein;

(2) He shall pay advertising expenses as shown on the bills presented and certified to be correct;

(3) He shall pay to the plaintiff the sum of $263.80 adjudged to plaintiff for costs and disbursements with interest thereon from the date hereof, also the sum of $50,594.72 the amount due plaintiff, as aforesaid, with interest thereon from and after January 15th, 1935, with taxes, insurance [fol. 53] and any other expenditures made by plaintiff in order to protect its mortgage lien herein and not included herein or in the Referee's report, or so much thereof as the purchase money of the mortgaged premises will pay and that he shall take a receipt therefor and file it with the report of sale; and

(4) He shall deposit the surplus money, if any, with the aforesaid depository within five days after he receives the same, to the credit of this action to be withdrawn only on order of this Court signed by a Justice of this Court; and it is further

Ordered, Adjudged and Decreed that the Referee make a report of the sale and file it with the Clerk of the County of Queens with all convenient speed, and that the purchaser or purchasers at said sale be let into possession upon the production of the Referee's deed, and if the proceeds of said sale be insufficient to pay the amount so found payable to the plaintiff, with interest and costs as aforesaid, said Referee shall state the amount of such deficiency in his report of sale, and in the event that the Court on subsequent application so directs, that the defendant Electro-Chemical Engraving Company, Inc., pay the same to the plaintiff and that plaintiff have execution therefor, and it is further

Ordered, Adjudged and Decreed, that the plaintiff may apply at the foot of this judgment after a sale thereunder, pursuant to Section 1083a of the Civil Practice Act for judgment herein against the defendant Electro-Chemical Engraving Company, Inc. for such deficiency, if any, as the

Court shall deem the plaintiff entitled to; and it is further
[fol. 54] Ordered, Adjudged and Decreed that in case the plaintiff shall be the purchaser at such sale or in the event that the rights of the purchaser at said sale and the terms of sale under said judgment shall be assigned to and acquired by the plaintiff and a valid assignment thereof filed with the said Referee, then the Referee shall give credit to the plaintiff upon the purchase price, the amount awarded to the plaintiff by this judgment and interest, upon plaintiff paying to the Referee in cash, an amount sufficient to pay the amounts specified above in items marked 1 and 2 and the amount of any taxes, assessments and water rates, and interest and penalties thereon, which are a lien on the mortgaged premises and an amount sufficient, to redeem the property sold from any sales for unpaid taxes, assessments, or water rates which have not apparently become absolute; and it is further

Ordered, Adjudged and Decreed that the plaintiff or his attorneys may waive the said requirement that said taxes, assessments, water rates and penalties be paid and that the property be redeemed from sales for unpaid taxes, assessments or water rates, as aforesaid, in which event the purchaser at the sale hereunder shall be entitled to a deed to the premises sold subject to said liens; and it is further

Ordered, Adjudged and Decreed, that the plaintiff or his attorneys may waive the requirement that a portion of the bid for said property be deposited with the Referee in which event the purchaser shall not be required to make any deposit in cash, or otherwise, for such purpose; and it is further

[fol. 55] Ordered, Adjudged and Decreed that in the event that after entry hereof and prior to the execution and delivery of the Referee's deed herein, plaintiff shall make any payments necessary in order to protect and preserve the plaintiff's said mortgage lien, the amount or amounts so paid together with interest on said items from the date of payment thereof, shall be added to and become part of the amount of the indebtedness found due the plaintiff, as aforesaid, and the plaintiff shall have the right to apply at the foot of this judgment or otherwise, for appropriate relief in that regard; and it is further

Ordered, Adjudged and Decreed that both of said defendants in this action and all persons claiming under both or either of them, subsequent to the filing of said notice of

pendency of action, and every person whose conveyance, encumbrance, chattel mortgage or conditional sales agreement is subsequent to or recorded subsequently to or is void against the plaintiff's lien, be and they hereby are forever barred and foreclosed of all right, title and interest, claim, lien and equity of redemption in said mortgaged premises or any part thereof, or in any fixture or articles of personal property attached to or used in connection therewith, and each and every part thereof; and it is further

Ordered, Adjudged and Decreed that said mortgaged premises be sold subject to any state of facts an accurate survey would show and the rights of tenants and lessees who are not parties defendant in this action.

The following is a description of the mortgaged premises covered by the aforesaid mortgage and which is to be sold as a single parcel:

[fol. 56] 1. All those certain lots, pieces or parcels of land, situate, lying and being in the City of New York, Borough of Queens (late Village of College Point, Town of Flushing), County of Queens and State of New York and designated as lots numbers 39, 41, 43, 45, 47, 49, 51, 53, 55, 57, 59, 61, 63, 65, 67, 69, 71, 2, 56, 54, 52, 50, 48, 121, 123, 125, 127, 129, 131, 133 in Block 45 on map of the Village of College Point, according to the Town Assessment Map of the Town of Flushing, Queens County, New York, and which said lots taken together are bounded and described as follows:

Beginning at a point formed by the intersection of the Southerly line or side of Third Avenue with the Westerly line or side of Tenth Street; running thence westerly along the Southerly line or side of Third Avenue 444 feet, more or less, to the Easterly line or side of Eighth Street; thence Southerly along said Easterly line or Side of Eighth Street 197 feet, more or less, to the Northerly line of lot number 1 on said map; thence Northeasterly and along lot number 1 on said map 101 feet 6 inches, more or less, to lot number 2 on said map; thence Southerly on the line dividing said lots numbers 1 and 2 on said map 75 feet 11¼ inches, more or less to the Northerly line or side of Fourth Avenue; thence Easterly along said Northerly line or side of Fourth Avenue 318 feet, more or less, to the Northwesterly corner of Fourth Avenue and Tenth Street, and thence Northerly along the Westerly line or side of Tenth Street 268 feet, more or less, to the point or place of beginning.

2. All the right, title and interest of the Mortgagor in and to that certain lot of land situate in the Borough of Queens [fol. 57] (formerly Village of College Point, in the Town of Flushing) of the City of New York, in the County of Queens and State of New York, and formerly designated as Lot No. 1 in Block 45 on Map of Village of College Point, according to the town assessment map of the Town of Flushing, Queens County, New York, and which said lot according to a survey thereof made by Leonard C. L. Smith, City Surveyor, dated July 1st, 1915 is particularly bounded and described as follows:

Beginning at the Northeasterly corner of Eighth Street and Fourth Avenue and running thence Easterly along the Northerly side of Fourth Avenue 100 feet 10 inches, more or less, to Lot No. 2 on said map; thence Northerly along said Westerly side of said Lot No. 2, 75 feet 11¼ inches, more or less; thence Southwesterly 102.43 feet, more or less, along the Northerly line of said Lot No. 1, to the Easterly side of Eighth Street and thence Southerly along the Easterly side of Eighth Street 50.14 feet to the point of beginning.

Enter, B. J. H., J. S. C.
Granted, Jan. 29, 1935, Jenkin R. Hockert, Clerk.
Judgment Entered Feb. 6, 1935, at 10:20 A. M.
Jenkin R. Hockert.

[fol. 58] Exhibit "D" Annexed to Stipulation

7569

$21.00 U. S. I. R. S. Cancelled:

This Deed, made the 22nd day of March, nineteen hundred and thirty five:

Between: Jonas Himmelfarbe, Referee, duly appointed in the action hereinafter mentioned, Grantor and Simon Bergman, of 122 East 42nd Street, New York, N. Y. Grantee.

Witnesseth: that the Grantor, the Referee, appointed in an action between Bernard Weinbaum, plaintiff and Electro Chemical Engraving Company, Inc., and The People of the State of New York, Defendants, foreclosing a mortgage, recorded on the 11th day of March, 1927, in the office of the Register of the County of Queens, in liber 3073 of

mortgages at page 320, in pursuance of a judgment entered at a special term of the Supreme Court, Queens County, on the 28th day of January, 1935, and in consideration of the sum of Twenty one thousand ($21,000) dollars, paid by the Grantee, being the highest sum bid at the sale under said judgment, does hereby grant and convey unto the Grantee All those certain lots, pieces or parcels of land, situate, lying and being in the City of New York, Borough of Queens, (late Village of College Point, Town of Flushing), County of Queens, and State of New York, and designated as lots numbers 39, 41, 43, 45, 47, 49, 51, 53, 55, 57, 59, 61, 63, 65, 67, 69, 71, 2, 56, 54, 52, 50, 48, 121, 123, 125, 127, 129, 131, 133, in block 45, on map of the Village of College Point, according to the Town Assessment Map of the Town [fol. 59] of Flushing, Queens County, New York, and which said lots taken together are bounded and described as follows:

Beginning at a point formed by the intersection of the southerly line or side of Third Avenue, with the westerly line or side of Tenth Street; running thence westerly along the southerly line or side of Third Avenue, 444 feet, more or less to the easterly line or side of Eighth Street; thence southerly along said easterly line or side of Eighth Street, 197 feet, more or less, to the northerly line of lot number 1, on said Map; thence northeasterly and along lot number 1 on said Map 101 feet 6 inches more or less, to lot number 2, on said Map; thence southerly on the line dividing said lots numbers 1 and 2 on said Map 75 feet, 11¼ inches, more or less to the northerly line or side of Fourth Avenue; thence easterly along said northerly line or side of Fourth Avenue, 318 feet, more or less, to the northwesterly corner of Fourth Avenue, and Tenth Street; and thence northerly along the westerly line or side of Tenth Street, 268 feet, more or less, to the point or place of beginning.

2. All the right, title and interest of the mortgagor in and to that certain lot of land, situate, in the Borough of Queens (formerly Village of College Point, in the Town of Flushing) of the City of New York, in the County of Queens, and State of New York, and formerly designated as lot No. 1, in Block 45, on Map of Village of College Point, according to the town assessment Map of the Town of Flushing, Queens County, New York, and which said lot according to a survey thereof made by Leonard C. L. Smith, City

Surveyor, dated July 1st, 1915, is particularly bounded and described as follows:

[fol. 60] Beginning at the northeasterly corner of Eighth Street and Fourth Avenue, and running thence easterly along the northerly side of Fourth Avenue, 100 feet, 10 inches, more or less, to lot No. 2, on said Map; thence northerly along said westerly side of said Lot No. 2, 75 feet 11¼ inches more or less; thence southwesterly 102.43 feet, more or less, along the northerly line of said Lot. No. 1, to the easterly side of Eighth Street; and thence southerly along the easterly side of Eighth Street, 50.14 feet to the point of beginning.

Subject nevertheless to all taxes, assessments, and water rates which are a lien upon said premises, to any state of facts an accurate survey would show, and to the rights of tenants, and lessees who were not parties defendant in said action.

To Have and to Hold the premises, herein granted unto the Grantee, his heirs, and assigns forever.

In Witness Whereof, the Grantor, has hereunto set his hand and seal.

Jonas Himmelfarbe (—)

In Presence of: Robert M. Bozeman.

[fol. 61] State of New York,
County of New York, ss:

On the 22nd day of March, nineteen hundred and thirty-five, before me came Jonas Himmelfarbe, to me known and known to me to be the individual described in, and who executed the foregoing instrument, and he acknowledged that he executed the same, as Referee, as aforesaid.

John Driscoll, Notary Public, Kings County Co. Clerks No. 82. Registers No. 6076. Certificate filed in Queens Co. Clerks No. 99. Registers No. 965. Nassau Co. and Suffolk Co. Commission expires March 30, 1936.

The land affected by the within instrument lies in Section 16, in Blocks 3951, 3953 on the Land Map of the County of Queens. Recorded March 25, 1935 at 10:30 A. M., at the request of Title Guarantee and Trust Company, Jamaica, N. Y.

[fol. 62] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

B. T. A. No. 89121

[Title omitted]

[File endorsement omitted.]

PRAECIPE FOR RECORD—Filed October 6, 1939

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Second Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.
2. Pleadings;
(a) Petition
(b) Answer to petition
[fol. 63] 3. Memorandum opinion entered April 24, 1939.
4. Decision entered June 6, 1939.
5. Petition for review.
6. Notices of filing petition for review.
7. Stipulation of agreed facts including Exhibits A, B, C and D attached thereto.
8. Praecipe for record.

(Signed) J. P. Wenchel, RLW., J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 4 day of October, 1939.

(Sgd.) B. S. Barron, Attorney for Respondent on Review.

JMM-pp 10-3-39.

[fol. 64] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 65] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1939

No. 221

(Argued January 17, 1940. Decided March 18, 1940)

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

against

ELECTO-CHEMICAL ENGRAVING CO., INC., Respondent

Petition by the Commissioner of Internal Revenue to review a determination of the Board of Tax Appeals adjudging a deficiency in income taxes of the respondent Electro-Chemical Engraving Co., Inc., for the year 1935, to the amount of $454.65. Reversed.

Before L. Hand, Augustus N. Hand and Chase, Circuit Judges

Samuel O. Clark, Jr., Assistant Attorney General, Sewall [fol. 66] Key and Arthur A. Armstrong, Special Assistants to the Attorney General, for the Commissioner of Internal Revenue.

Barron, Rice & Rockmore, Attorneys for Respondent Electro-Chemical Engraving Co., Inc.; Bernard S. Barron, Counsel.

AUGUSTUS N. HAND, Circuit Judge:

The question before us is whether a loss sustained by the taxpayer Electro-Chemical Engraving Co., Inc., through a sale of its factory by foreclosure should be limited to $2,000 by reason of Section 117 (d) of the Revenue Act of 1934, instead of being deductible to the extent of the excess of the adjusted basis over the amount realized, as provided in Sec. 111 (a).

The Board of Tax Appeals determined that the taxpayer was entitled to deduct the actual loss realized and that after such deduction there was no deficiency in excess profits tax for the year 1935. If the deduction was limited to $2,000 there would be a deficiency of $2,547.08 in excess-profits tax and the order of the Board should be modified so as to adjudge that deficiency as assessed by the Commissioner. In our opinion the Commissioner was right in holding that

Section 117 (d) applied and that the deductible loss in capital assets was only $2,000 and that a deficiency of $2,547.08 in excess-profits tax existed.

Under Section 23 (j) of the Revenue Act of 1934 it is provided that: "Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in Section 117 (d) * * *."

Section 117 (d) of the Act of 1934 provides that:

"(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the [fol. 67] extent of $2000 plus the gains from such sales or exchanges * * *."

In Section 117 (b) capital assets are thus defined:

"(b) *Definition of Capital Assets.*—For the purposes of this title 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

The taxpayer's factory, which clearly was a "capital asset", was subject to a purchase money mortgage. Because of defaults in payment of principal and interest, one Weinbaum, who had become the owner of the mortgage by assignment, started a suit to realize the amount of his lien by foreclosure. At the foreclosure sale, on March 7, 1935, the property was bid in by one Bergman for $21,000 leaving a deficiency of $30,428.33, and on March 22, 1935, the referee, pursuant to the decree of foreclosure, executed a deed conveying the premises to the purchaser. The latter did not attempt to enforce the deficiency against the taxpayer under the provisions of Section 1083-a of the New York Civil Practice Act so that under that section the proceeds must be deemed "in full satisfaction of the mortgage debt and no right to recover any deficiency in any action or proceeding shall exist."

The question before us is whether the Commissioner was right in claiming that the transfer of the factory to Bergman by the referee was a "sale" within the meaning of

Section 117 (d) of the Revenue Act so that the deductible loss in capital assets fixed thereby was limited to $2,000. [fol. 68] Otherwise, Section 23 of the Revenue Act of 1934 would be applicable, which provides that:

"In computing net income there shall be allowed as deductions: * * *

"(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

In Commissioner v. Freihofer, 102 F. (2d) 787, the Court of Appeals for the Third Circuit held that a transfer of mortgaged property to a third party as the result of a foreclosure sale was not a "sale" within the meaning of Section 117 (d) because that section only related to sales voluntarily made and not to transfers as a result of decrees of foreclosure, which the court regarded as involuntary so far as the mortgagors are concerned.

The respondent relies on the decision in Commissioner v. Freihofer, supra, and that of the Sixth Circuit in Commissioner v. Hammel, 108 F. (2d) 753, to negative the Commissioner's ruling that the case at bar is governed by Sec. 117 (d). In Commissioner v. Hammel the court laid stress on the law of Michigan, where the real estate involved was situated. That law permitted the interest of a mortgagor or of a purchaser who had defaulted under a contract for the sale of land to be barred by a decree of "strict foreclosure". The court held that termination of the interest of the legal or equitable owner of real estate by such a decree could not reasonably be regarded as a sale and that a sale by a sheriff in a foreclosure suit to which a mortgagor or a vendee who had defaulted on his contract of purchase was not a party was also not a sale within Sec. 117 (d) and that the taxpayers should be allowed their capital loss, and not be subjected to the limitation of $2000.

[fol. 69] We feel compelled to differ with the foregoing decisions and to hold that Sec. 117 (d) applies to the present case and precludes the allowance of a deduction of more than $2000. Section 117 (d) does not confine the meaning of the word "sale" to voluntary transfers by the taxpayer nor can we see any reason for discriminating between the liquidation of a taxpayer's interest through sales made by himself and sales made by an officer of the court.

We should be surprised if a taxpayer who had pledged securities with a broker and had them sold out on the Stock Exchange could obtain a deduction of more than $2000 for a capital loss incurred through such a liquidation. If the sale were made at the pledgor's request it could not be doubted that 117 (d) would apply and that no loss in excess of $2,000 could be deducted for income tax purposes. Rogers v. Commissioner, 103 F. (2d) 790 (C. C. A. 9). Likewise, if the customer realized a gain through such a liquidation he would be entitled to limit his taxable gain in computing net income to the percentages provided by Section 117 (a). It cannot be supposed that it would make any difference whether a pledgee ordered or merely suffered his securities to be sold by his broker, and we think that in either event he could limit his taxable gain by the percentages under Section 117 (a) and could take a deduction of only $2,000 for any loss that he might suffer. We see no valid distinction between a sale by a broker who holds his customer's securities and a sale of mortgaged real estate by means of a decree in foreclosure. If Section 117 (d) does not include cases of strict foreclosure that fact is not persuasive of the result to be reached here. Strict foreclosure is a procedure now existing in but few states of the union and is no longer permissible in New York where the real estate in question was situated. Moulton v. Cornish, 138 N. Y. 133; Tiffany Real Property (2nd Ed.) § 650.

Commissioner v. Bingham, 105 F. (2d) 971 (C. C. A. 2) is not in conflict with the decision we have reached. In the [fol. 70] Bingham case it was held that the vendor-mortgagee might deduct his full loss resulting from cancellation of notes secured by a purchase money mortgage and taking back the property in exchange. It is true that the situation somewhat resembled one where there is a foreclosure sale without deficiency judgment. But the Bingham case involved taxation of the mortgagee, who could be said only to have "sold" the notes. That a cancellation of notes is not a "sale" of them to their maker was the ground the court relied on. It did not determine that the mortgagor did not "sell" the real estate to the mortgagee, with the cancellation of the notes as consideration. In Commissioner v. Rogers, 103 F. (2d) 790, the Ninth Circuit held in similar circumstances that the mortgagors had effected a sale and confined their deductible loss to the statutory limitation. Between a situation adjusted by cancellation of the mort-

gage notes in return for a "voluntary" deed of the land, when the adjustment is made with knowledge of the possible resort to forecolsure, and a situation where foreclosure is actually resorted to, there would seem to be little difference. In both situations, the result is the same: the mortgagee receives back the land, and the mortgagor is freed of liability on the mortgage notes, to some extent at least.

If capital losses were limited to $2,000 only in case of voluntary sales a taxpayer could frequently secure the benefit of an ordinary loss deduction through liquidation of pledged or mortgaged property by a friendly broker or mortgagee. It seems to us quite unlikely that the national revenue can be affected by such distinctions or by the accident of who causes the sale to be made. It is enough if there is an identifiable event by way of sale or exchange resulting in the realization of a loss or gain.

The order of the Board is reversed and the cause remanded for recomputation of the deficiency after disallowing all but $2000 of the loss involved herein.

[fol. 71] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 3rd day of April, one thousand nine hundred and forty.

Present: Hon. Learned Hand, Hon. Augustus N. Hand, Hon. Harrie B. Chase, Circuit Judges.

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

ELECTRO-CHEMICAL ENGRAVING CO., INC., Respondent

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is reversed and

cause remanded for recomputation of the deficiency after disallowing all but $2000 of the loss involved herein.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

D. E. Roberts, Clerk.

[fol. 72] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. Commissioner of Int. Revenue v. Electro-Chemical Engraving Co., Inc. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed April 3, 1940. D. E. Roberts, Clerk.

[fol. 73] UNITED STATES OF AMERICA,
Southern District of New York:

I, D. E. Roberts, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 72, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of Commissioner of Internal Revenue, Petitioner, against Electro-Chemical Engraving Co., Inc., Respondent, as the same remain of record and on file in my office.

In Testimony Whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 3rd day of April, in the year of our Lord one thousand nine hundred and forty, and of the Independence of the said United States the one hundred and sixty-fourth.

D. E. Roberts, Clerk. (Seal.)

[fol. 74] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed June 3, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is assigned for argument immediately following No. 895.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsed on Cover:] File No. 44,369. U. S. Circuit Court of Appeals, Second Circuit. Term No. 62. Electro-Chemical Engraving Co., Inc., Petitioner, vs. Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed May 1, 1940. Term No. 62 O. T. 1940.

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FILE COPY

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FILED
MAY 1 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term 1939.
No. 62

ELECTRO-CHEMICAL ENGRAVING CO. INC.,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF.

BERNARD S. BARRON,
Counsel for Petitioner.

THE COURT PRESS, N. Y. C.

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IN THE

Supreme Court of the United States

October Term, 1939.

No.

ELECTRO-CHEMICAL ENGRAVING CO. INC.,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Electro-Chemical Engraving Co. Inc., shows to the court as follows:

STATEMENT.

This is a petition for a writ of certiorari to review a judgment of the United States Circuit Court of Appeals for the Second Circuit entered on April 3rd, 1940 (p. 71) reversing a decision of the United States Board of Tax Appeals.

STATEMENT OF THE CASE.

The Commissioner of Internal Revenue, on March 15, 1939, determined a deficiency against the petitioner

for its income and excess profits taxes ($14,035.71 and $2,547.08 respectively) for the calendar year of 1935. The petitioner on May 19, 1939 petitioned the United States Board of Tax Appeals for a redetermination of the deficiency. The Board of Tax Appeals on June 16, 1939 decided in favor of the petitioner. Thereupon the Commissioner petitioned the United States Circuit Court of Appeals for the Second Circuit to review the decision of the United States Board of Tax Appeals. The Circuit Court of Appeals for the Second Circuit on March 18, 1940, in a written opinion, reversed the decision of the Board of Tax Appeals (pp. 66-70).

The Facts.

The facts in this case, as stipulated (pp. 32-36), are briefly as follows:

The petitioner is a corporation organized under the laws of the State of New York. The respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States. The petitioner filed its income and excess profits tax return for the calendar year 1935 with the Collector of Internal Revenue for the Third District of New York. In that return petitioner deducted a loss of $101,077.44, resulting from the foreclosure of its factory property. The Commissioner of Internal Revenue refused to allow this deduction, contending that the loss was limited to $2,000 by Section 117(d) of the Revenue Act of 1934. The Board of Tax Appeals held that this was not a "sale or exchange" within the meaning of the Revenue Act and allowed the loss in full.

The Question Involved.

Did the loss suffered by the petitioner through the foreclosure of its real property and the extinguishment of its equity therein result from a sale or exchange within the meaning of Section 117(d) of the Revenue Act of 1934?

Reasons for Granting the Writ.

1. The decision below is in direct conflict with the decision of the United States Circuit Court of Appeals for the Third Circuit, in *Commissioner of Internal Revenue* v. *Freihofer,* 102 F. (2d) 787 (March 15, 1939) and in similar conflict with the decision of the United States Circuit Court of Appeals for the Sixth Circuit, in *Commissioner of Internal Revenue* v. *Hammel,* 108 F. (2d) 753 (January 10, 1940). The Solicitor General did not apply for a writ of certiorari in *Commissioner* v. *Freihofer* and the time in which to make such application has expired. On April 10, 1940, the Solicitor General applied to this Court for a writ of certiorari in the *Hammel* case. The application has not as yet been acted on by this court.

2. The Circuit Court has decided an important question of federal law which has not been, but should be, settled by this court. The statute involved (Sec. 117(d) of the Revenue Act of 1934) has not yet been before this Court for construction. The same section (identically numbered) is found in the Revenue Act of 1936 and the Revenue Act of 1938. The decision below, in the instant case, is of far reaching importance in that it will hereafter continue to affect the income tax liability of taxpayers who suffer losses as a consequence of foreclosure proceedings.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this honorable court directed to the United States Circuit Court of Appeals for the Second Circuit commanding that court to certify and send to this court on a day designated for its review and determination, a full and complete transcript of the record and full proceedings in said Circuit Court of Appeals had in the case No. 221 and entitled "Commissioner of Internal Revenue, petitioner, vs. Electro-Chemical Engraving Co. Inc., respondent" to the end that said case may be reviewed and determined by this court as provided by law; that the determination of the United States Circuit Court of Appeals for the Second Circuit, may be reversed, and that your petitioner may have such other and further relief as may be just.

ELECTRO-CHEMICAL ENGRAVING CO. INC.,
By BERNARD S. BARRON,
Counsel for the Petitioner.

IN THE

Supreme Court of the United States

October Term, 1939.

No.

ELECTRO-CHEMICAL ENGRAVING CO. INC.,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinion Below.

The memorandum opinion of the Board of Tax Appeals is printed at pages 18-20 of the record and is not officially reported. The opinion of the Circuit Court is printed at pages 66-70 of the record and is not yet officially reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 3rd, 1940 (p. 71). Jurisdiction is conferred upon this Honorable Court by Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statement of Case.

The facts have been set forth in the petition (p. 2).

Specification of Error.

The Circuit Court erred in holding that the divestiture of the taxpayer's property and the extinguishment of his equity therein by the decree of foreclosure was a "sale" within the meaning of Section 117(d) of the Revenue Act of 1934.

The Statutes Involved.

Revenue Act of 1934, C. 277, 48 Stat. 680; Sec. 23. Deductions from gross income.

"In computing net income there shall be allowed as deductions: * * *

(f) Losses by Corporations.—In the case of a corporation, the losses sustained during the taxable year and not compensated for by insurance or otherwise."

Revenue Act of 1934 (U. S. C., Title 26, seq. 111):

"Section 117, Capital Gains and losses:

* * *

(d) Limitation on capital losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2000. plus the gains from such sales or exchanges * * *."

Argument.

The decision below, in direct conflict with decisions of the Circuit Courts in the Third and Sixth Circuits, involves an important question of Federal Law which has not yet been, but should be, settled by this court.

In *Commissioner* v. *Freihofer,* 102 F. (2d) 787, the taxpayer's mortgaged property was sold by the sheriff under an execution writ issued in a Pennsylvania statutory foreclosure proceeding. The taxpayer claimed the right to deduct the entire amount of his loss (in excess of $2000.) under Section 23(f) of the Revenue Act of 1934. The Circuit Court for the Third Circuit decided that a foreclosure sale was an involuntary sale; that Section 117(d) contemplated only *voluntary* sales; and that the taxpayer was therefore entitled to deduct his loss in full under Section 23(f) of the Revenue Act of 1934. It expressly ruled (p. 790):

> "* * * that the sales of capital assets referred to in Section 117 are those sales only which are voluntarily made by a taxpayer and that judicial sales made by the sheriff in execution of a judgment in a proceeding for the foreclosure of a mortgage given by a prior owner are not included."

In *Commissioner* v. *Hammel,* 108 F. (2d) 753, the taxpayers' property was foreclosed and the sheriff, pursuant to the foreclosure decree, sold the property at public auction. The taxpayers deducted the entire loss incurred as a consequence of the foreclosure. The Circuit Court of Appeals for the Sixth Circuit, in sustaining the deduction, said:

> "The respondents in the case at bar were not

parties to the sheriff's sale and neither contracted for nor consented to it and received no part of the consideration. They were deprived of their interest in the property not by sale but by an adverse judicial proceeding which completely extinguished their title without consideration. The foreclosure was the identifiable event which established their loss. However, it was not established by a sale as that word is used in Section 117 of the Revenue Act of 1934. *Commissioner of Internal Revenue* v. *Freihofer,* 3 Cir., 102 F. (2d) 787; *Burnet* v. *Harmel,* 287 U. S. 103, 107, 53 S. Ct. 74, 77 L. Ed. 199; *Hale* v. *Helvering,* 66 App. D. C. 242, 85 F. (2d) 819."

In the instant case, on identical facts, the Circuit Court of Appeals for the Second Circuit held that the divestment of title by foreclosure *was* a sale, and declined to follow the foregoing decisions. It said:

"The respondent relies on the decision in *Commissioner* v. *Freihofer, supra,* and that of the Sixth Circuit in *Commissioner* v. *Hammel,* 108 Fed. (2d) 753, to negative the Commissioner's ruling that the case at bar is governed by Section 117(d).

"We feel compelled to differ with the foregoing decisions and to hold that Section 117(d) applies to the present case and precludes the allowance of a deduction of more than $2000." (Italics ours.)

The irreconcilable conflict between the Second and the Third and Sixth Circuits is thus apparent.

Numerous cases have been decided by the Board of Tax Appeals involving the construction of Section

117(d) of the Revenue Act of 1934, with reference to foreclosure losses, all favorable to the taxpayer.[1] Numerous cases involving the same question are now pending there and in the Circuit Courts.[2] Section 117(d) of the Revenue Act of 1934 is repeated in identical language in the Revenue Acts of 1936 and 1938. It is reasonable to assume, therefore, that numerous cases will continue to come before the Board with consequent confusion because of the conflict in the Circuits. It is important that this vital question should be determined by this Court; otherwise, tax liability will be dependent not on a uniform rule of interpretation of the Revenue Act, but on the residence of the taxpayer in a particular judicial circuit.

CONCLUSION.

In order that the conflict of the decision below with the decisions of the Circuit Courts for the Third and Sixth Circuits may be resolved, and in order that the important question involved in the application of the tax laws may be settled by this court, it is submitted that the petition for a writ of certiorari be granted.

Respectfully submitted,

BERNARD S. BARRON,
Counsel for Petitioner.

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[1] *Watson* v. *Commissioner*, 27 B. T. A. 463;
Hawkins v. *Commissioner*, 34 B. T. A. 139;
Commonwealth v. *Commissioner*; 36 B. T. A. 850;
Warfield v. *Commissioner*, 38 B. T. A. 907;
Rust v. *Commissioner*, 38 B. T. A. 910 (and others).

[2] *Coggan* v. *Commissioner* now pending C. C. A. 1st Circuit;
Hill v. *Commissioner* now pending C. C. A. 6th Circuit;
Bookstein v. *Commissioner* now pending C. C. A. 6th Circuit;
Nebraska Bridge Supply & Lumber Co. v. *Commissioner* now pending C. C. A. 8th Circuit;
Jones v. *Commissioner* now pending C. C. A. 8th Circuit.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940—NO. 62.

ELECTRO-CHEMICAL ENGRAVING CO. INC.,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONER.

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—against—

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Respondent.

BRIEF FOR PETITIONER.

Opinions Below.

The memorandum opinion of the Board of Tax Appeals is printed at pages 18-20 of the record and has not been officially reported. The opinion of the Circuit Court of Appeals is printed at pages 66-70 of the record, and is reported in 110 F. (2d) 614.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 3rd, 1940. Jurisdiction is conferred by Section 240(a) of the Judicial Code, as amended by the Act of February 13th, 1925.

This cause comes here by virtue of a writ of certiorari granted on June 3rd, 1940.

The Statutes Involved.

Revenue Act of 1934, c. 277, 48 Stat. 680:

"Sec. 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

* * * * * * * * *

"(f). Losses by Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

* * * * * * * * *

"(j). Capital Losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117(d)."

* * * * * * * * *

"Sec. 117(d). Limitation on Capital Losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000. plus the gains from such sales or exchanges * * *."

Statement of Stipulated Facts (R., pp. 18-37).

On March 1st, 1927, the petitioner, a New York corporation, purchased a factory for its own business use in Flushing, New York, for $156,764.51 ($150,000 plus expenses of $6,764.51). It paid $50,000 in cash, assumed an existing first mortgage indebtedness of $20,000, and executed a bond in the sum of $80,000 which was secured by a purchase money mortgage on the property. On or about March 14th, 1930, the petitioner paid the first mortgage indebtedness of $20,000 and thereafter paid off $40,000 on the purchase money bond and mortgage, leaving a balance thereon of $40,000. On September 1st, 1932 the petitioner defaulted in the payment of the sum of $4,000 required to be paid in reduction of the principal of the purchase money mortgage and in the payment of

all subsequent semi-annual instalments of principal, and defaulted in the payment of the semi-annual instalment of interest required to be paid on September 1st, 1934 and all subsequent semi-annual instalments of interest, and defaulted further in the payment of real estate taxes for the second half of the year 1932 and in the payment of all subsequent real estate taxes.

In December 1934 Bernard Weinbaum, who, by assignment, had become the owner and holder of the purchase money mortgage, brought an action of foreclosure, because of the defaults mentioned, against the petitioner in the Supreme Court of the State of New York. On or about *February 6, 1935* a judgment of foreclosure was duly entered, forever barring the petitioner from its right, title and interest and equity of redemption in the premises, and awarding a judgment in favor of Bernard Weinbaum and against the petitioner in the sum of $50,594.72, consisting of the sum of $40,000 representing the unpaid principal of the mortgage debt, interest of $2,100, and unpaid real estate and water taxes and penalties thereon in the amount of $8,494.72. Pursuant to the aforesaid judgment of foreclosure, the referee appointed by the court, sold the mortgaged premises on *March 7th, 1935,* to Simon Bergman for the sum of $21,000 subject to all unpaid taxes, assessments and water charges then a lien on the premises, and on *March 22nd, 1935* the referee executed a deed conveying title to the premises to said Simon Bergman, a person unknown to the petitioner.

The cost of the property to the petitioner was $156,764.51. From this was deducted the mortgage payable of $40,000, the reserve for depreciation amounting to $15,993.13, and accrual of taxes and interest in the sum of $12,009.17—a total deduction of

$68,002.30. This left a net loss to the petitioner of $86,762.21.

The petitioner filed its income and excess profits tax return for the calendar year 1935 with the Collector of Internal Revenue for the Third District of New York, and therein deducted this last amount from its income as a loss sustained during the year. In his notice of deficiency to the taxpayer for the return for said year the Commissioner added to income the accrued taxes and interest in the amount of $12,009.17, and disallowed the amount of $86,762.21 of the claimed loss of $88,762.21.

The Board of Tax Appeals ruled that the Commissioner was correct in adding to income the amount of $12,009.17, and that such amount should not be offset against the cost of the property to the taxpayer, with the result that such loss was increased to $100,771.38. Such loss, it further held, was not the result of a "sale or exchange" within the meaning of the Revenue Act, and allowed it in full. The Circuit Court reversed the Board and held that the loss was limited to $2,000.

The Questions Presented.

1. Was the loss suffered by petitioner upon the foreclosure of its property a loss resulting from a "sale or exchange" of a capital asset, within the meaning of Section 117(d) of the Revenue Act of 1934?

2. Was the foreclosure sale the specific event establishing petitioner's loss?

Summary of Argument.

Petitioner neither sold nor exchanged its property. It lost its property through the operation of the law of foreclosure. Its interest was extinguished by an involuntary disposition thereof, without consideration. The referee's sale merely implemented the decreed forfeiture of petitioner's estate. This divestiture was not a "sale" within the meaning of the Act, which contemplated conventional, *voluntary,* dispositions of capital assets *by* the taxpayer.

Moreover, the referee's sale was not the identifiable event establishing petitioner's loss. The "sale" was an incidental and purely ministerial act in the process of the foreclosure of petitioner's property. The loss, referable to the foreclosure as an integrated whole, was not attributable to any specific step in the foreclosure. In any event the loss was not established, with precision and finality, until after the expiration of the period within which the statutory deficiency judgment procedure could be invoked.

POINT ONE.

The judicial divestiture of petitioner's property was not a "sale" thereof within the meaning of Section 117(d) of the Revenue Act of 1934.

I.

Section 117(d), by its terms, is applicable only where the loss results from a "sale or exchange".

The Board held that "a foreclosure sale is not a sale or exchange within the purview of Section 117(d) of the Revenue Act of 1934" (R., p. 11, fol. 18). In reversing the Board, the Circuit Court stated that

it could perceive no "reason for discriminating between the liquidation of a taxpayer's interest through sales made by himself and sales made by an officer of the court" (R., p. 41, fol. 69; 110 F. (2d) at p. 616). The ruling, we submit, ignores the fundamental distinction between a sale (connoting contractual and dispositive volition) and a judicial divestment of title, *i. e.*, forfeiture by decree.

Implicit in the conception of a "sale" is its *voluntary*[1] character, the contractual participation of the seller in the transaction, his formulation of terms, and assent to the bargain—in short, the free play of volition. In the language of the Sixth Circuit, in a case which is here on a companion writ:

> "'Sale' is a word of precise legal import. Its elements are (1) parties competent to contract, (2) mutual consent, (3) a thing the absolute or general property in which is transferred from the seller to the buyer, (4) a price in money paid or promised. (*Butler* v. *Thomson,* 92 U. S. 412 414; *Williamson* v. *Berry,* 49 U. S. 495, 544.) * * * If any one of the above elements be absent, it is not a sale as that word is understood in its ordinary signification." (*Commissioner* v. *Hammel,* 108 F. (2d) 753.)

On the other hand, implicit in the conception of a judicial sale is its *involuntary* character. It has been

[1] In the field of contract, generally, this view has prevailed. The ordinary power of sale has reference to a conventional, contractual, disposition, not to a judicial sale (*Guaranty Trust & Safe Deposit Co.* v. *Green Cove S & M R Co.,* 139 U. S. 137). And a covenant against sale or assignment is not broken either by a transfer by operation of law (*Gazlay* v. *Williams,* 210 U. S. 41), or by a judicial sale *in invitum* (*Riggs* v. *Pursell,* 66 N. Y. 193).

described as an "adverse", "involuntary", "hostile" proceeding (see, generally, 35 C. J. 7, Sec. 1, *et seq.*; *Mitchell* v. *Bartlett,* 51 N. Y. 447, 452), in which the owner is not an actor, but is acted against. On such a sale owner and plaintiff "do not bear the relation of vendor and vendee to each other" (*Mitchell* v. *Bartlett,* 51 N. Y. 447, 452). Indeed, the owner has "no right, power or authority to deal with the purchaser" (id.). He must stand aside while the decree is carried through by the enforced stripping of his title. Not even by equitable fiction is he regarded as a party to the contract—made over the auction block—with the successful bidder. "In effect the contract is made with the *court* * * *" (*Lane* v. *Chantilly Corp.,* 251 N. Y. 435, 437), And the referee or master, who conducts the sale does so as "a representative of the court" (*Pewabic Mining Co.* v. *Mason,* 145 U. S. 349, 361-2); he is not under the control of any party to the litigation, nor is he "the agent of either to make the sale" (id.; see also, *Mitchell* v. *Bartlett, supra*).

It is thus apparent that the process of wresting title from one party and investing it in another through the device of a referee's deed (which the owner has neither signed, authorized, approved, nor even been consulted upon), lacks every essential attribute of a "sale" in the ordinary legal significance of the word.[2] In the lay mind as well the word "sale"

---

[2] Of course, in a special, narrowly literal sense, the "highest bidder" at the referee's "auction" of the property becomes the "purchaser" under the foreclosure judgment. But, as we have seen, the mortgagor is not the *seller* (see cases, *supra*)—a conclusion which makes it impossible to reconcile the decision below with the (presumably) normal, conventional intendment of the term "sale" as used in the statute. In its application to a particular taxpayer, Section 117(d) governs *his* transactions, deals with *his* gains, *his* losses, *his* capital assets and therefore with *his* sales and *his* exchanges.

evokes no mental picture of a judicial officer, with a writ in one hand and an auctioneer's hammer in the other, selling under compulsory judicial decree the property of one who stands by, powerless to prevent the transaction or dictate the price or terms thereof. In short, "there is nothing * * * in the language of the Act indicating that the Congress used the word 'sale' in any sense other than its precise legal import or plain and obvious meaning" (*Commissioner* v. *Hammel, supra*).

II.

Respondent's conception of the term: "foreclosure sale", involves, in effect, the deletion of the qualifying word "foreclosure", and the placing of a blind emphasis upon the word "sale". It requires, as well, a disregard of the historic significance of the term. To view a decreed foreclosure sale in isolation, and to wrap it in the meaning of a sale by treaty, is to ignore its essential nature and adopt a "distorted rather than the common meaning of the word 'sale'" (*Burnet* v. *Harmel,* 287 U. S. 103, 108).

That a change of ownership is an incident of a foreclosure action is not at all conclusive; nor, in view of the setting in which the change takes place, is that circumstance even persuasive of the inquiry of whether a "sale" has occurred (cf. *Burnet* v. *Harmel, supra*).

In the *Burnet* case, this court sustained the contention that the consideration for the granting of an oil and gas lease was taxable as ordinary income rather than income from a "sale or exchange", even though under the applicable law the lease was regarded as a present sale of the oil and gas in place. The normal

meaning of the term "sale" was held to control, "notwithstanding this incidental transfer of ownership * * *"

The Court of Appeals for the District of Columbia in *Hale* v. *Helvering,* 85 F. (2d) 819, likewise refused to permit the element of an incidental transfer of ownership to dominate the analysis. There the mortgagee compromised the balance of the mortgage debt for a certain sum paid by the mortgagor, and, as part of the compromise, surrendered the notes which secured the debt. The court rejected the contention that the mortgagee's loss resulted from a "sale" of the notes, as capital assets. This ruling was followed by the Second Circuit in the *Bingham* v. *Commissioner,* 105 F. (2d) 971.

III.

Persuasive evidence of the sense in which Congress used the term "sale" is found in the reports of the Congressional committees which considered the legislation.[3] The first capital loss limitation appeared in the Revenue Act of 1924 as Section 208 (c). When the measure was under consideration by the House Ways and Means Committee, the Committee noted, among other things, that under the Revenue Act of 1918 "there was a serious loss of revenue, *in that the initiative, as is always the case, remained with the taxpayer, who refrained from taking a profit but who did not hesitate to take a loss which could be deducted in full from his taxable income".* (H. Rep. No. 1388

[3] The doubt engendered by the conflicting opinions of the Circuit Courts would seem to furnish ample basis for a resort to these reports, under the rule stated in *Wright* v. *Mountain Trust Bank,* 300 U. S. 440, 463.

of the House Ways and Means Comm. on H. R. 13770, 67th Cong. 4th Sess.)

The Revenue Act of 1934 introduced the new method of taxing gains from the sale or exchange of capital assets which is set forth in Section 117 of the act, and at the same time limited the deductions of losses from sales or exchanges of capital assets to $2,000 in excess of the gains from such transactions. The reason for this change appears from the following excerpts from the report upon the bill of the House Ways and Means Committee (House Report #704, 73rd Cong. 2nd Sess.):

> "Existing law provides in section 101 for a special treatment of the gains and losses resulting from the sale of capital assets held over 2 years * * *
>
> "Our present system has the following defects:
>
> "First. It produces an unstable revenue—large receipts in prosperous years, low receipts in depression years.
>
> * * * * * * * *
>
> "Third. *Taxpayers take their losses* within the 2 year period and get full benefit therefrom, and delay taking gains until the 2 year period has expired, thereby reducing their taxes."
>
> * * * * * * * *
>
> "Fifth. In some instances, normal business transactions are still prevented on account of the tax.
>
> "* * * Your committee recommends the following plan:
>
> "First. To measure the gain or loss *from the*

sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes:

"One hundred per cent if the capital asset has been held for not more than 1 year;

"Eighty per cent if the capital asset has been held for more than 1 year but not more than 2 years;

* * * * * * * *

"It is believed that the adoption of this plan (see Sec. 117 of the bill) will result in much greater stability in revenue, will give all taxpayers equal treatment, will encourage *normal business transactions,* and will yield substantially greater revenue. * * *"

Commenting on the above quoted language of the above mentioned report, the Third Circuit, in *Commissioner* v. *Freihofer,* 102 F. (2d) 787, said:

"These statements, which were quoted with approval by the Finance Committee of the Senate in its report upon the bill (Senate Report No. 558, 73rd Cong., 2d Sess.), show quite convincingly that *it was the intent of the Congress to deal in Section 117 with gains and losses resulting from the voluntary sale of capital assets.* The Committee said that the plan of taxation contained in the act was 'to measure the gain or loss from the sale of property by an individual according to the length of time he has held the property'. It would be difficult to find a clearer statement of the Congressional intent than this. We think it compels the conclusion that the sale

of capital assets referred to in Section 117 are those sales only which are *voluntarily* made by a taxpayer and that *judicial sales made by the sheriff in execution of a judgment in a proceeding for the foreclosure of a mortgage given by a prior owner are not included.*" (Italics ours.)

IV.

The ruling of the Board, in the instant case, is in harmony with a long line of identical rulings (see, among others, *Warfield* v. *Commissioner,* 38 B. T. A. 908; *Rust* v. *Commissioner,* 38 B. T. A. 910; *Jones* v. *Commissioner,* 39 B. T. A. 531; *Hill* v. *Commissioner,* 40 B. T. A. 376; *Fowler* v. *Commissioner,* 40 B. T. A. 1292; cf. *Nebraska Bridge Supply & Lumber Co.* v. *Commissioner,* 40 B. T. A. 40 [tax sale]; *Ganopuls* v. *Commissioner,* 39 B. T. A. 1120 [termination of estate by forfeiture. notice]), and is supported, moreover, by carefully considered decisions of the Third and Sixth Circuits (*Commissioner* v. *Freihofer,* 102 F. (2d) 787; *Commissioner* v. *Hammel,* 108 F. (2d) 753).

In the *Freihofer* case, the Third Circuit said:

> "Blackstone defined a sale as 'a transmutation of property from one man to another in consideration of some price or recompense in value' 2 Bl. 446. It is a contract for the transfer of property from one person to another for a valuable consideration. See 7 Words and Phrases, First series, Sale, page 6291. There must be parties standing to each other in the relation of buyer and seller, their minds must assent to the same proposition, and a consideration must pass.

Butler v. *Thomson*, 92 U. S. 412, 23 L. Ed. 684. Where the word is used, in the absence of anything to the contrary it will be assumed that the word is intended to have its usual signification. *De Ganay* v. *Lederer*, 250 U. S. 376, 39 S. Ct. 524, 63 L. Ed. 1042; *State* v. *Colonial Club*, 154 N. C. 177, 69 S. E. 771, 31 L. R. A. N. S. 387, Ann. Cas. 1912A, 1079. That signification includes voluntary action by the owner and a consideration. Here the taxpayer, the owners of the properties involved in the foreclosures, were not parties to the sheriff's sales, nor did they receive any part of the price obtained at those sales. These were, therefore, not sales in the ordinary sense. On the contrary they were adverse judicial proceedings whereby the titles of the taxpayers were extinguished, as we shall presently point out, without any recompense."

The *Freihofer* case was followed by the Sixth Circuit, in the *Hammel*[4] case. There the court, after adverting to the contractual connotation of the term "sale", said:

"The respondents in the case at bar were not

[4] The attempt of the court below to distinguish the *Hammel* case from the case at bar seems factually and legally untenable. A reading of the opinion in the *Hammel* case hardly justifies the assumption of Judge A. N. Hand that a "strict foreclosure" was there involved; nor, since a deficiency judgment was obtained against Mr. and Mrs. Hammel, and an appeal had been taken by them, is there basis for the apparent assumption that they were not parties to the foreclosure action. Be that as it may, the *Hammel* case was decided on no such narrow grounds; on the contrary the ruling was put forth on the broad ground that the Hammels "were deprived of their interest in the property not by sale but *by an adverse judicial proceeding which completely extinguished their title without consideration.*"

parties in the sheriff's sale and neither contracted for nor consented to it and received no part of the consideration. They were deprived of their interest in the property not by sale but by an adverse judicial proceeding which completely extinguished their title without consideration. The foreclosure was the identifiable event which established their loss. However, it was not established by a sale as that word is used in Section 117 of the Revenue Act of 1934. *Commissioner of Internal Revenue* v. *Freihofer,* 102 Fed. (2d) 787 (C. C. A. 3); *Burnet* v. *Harmel,* 287 U. S. 103, 107; *Hale* v. *Helvering,* 85 Fed. (2d) 819 (C. C. A. D. C.)."

In their essential features, both the *Freihofer* and the *Hammel* cases are indistinguishable from the instant case: in each case the taxpayer had been stripped of his title by foreclosure. The legal significance of such a result, in the light of federal taxation statutes, "is a federal question" (*Lyeth* v. *Hoey,* 305 U. S. 188, 193). "It is not determined by local characterization" (id.), nor by variations in the pattern of local foreclosure procedures. On the contrary, the will of Congress controls, and should be interpreted "so as to give a uniform application to a nationwide scheme of taxation" (*Burnet* v. *Harmel,* 287 U. S. 103, 110; *Lyeth* v. *Hoey, supra*).

Still other cases have been resolved by the same test, *i. e.,* whether the transfer was the result of a *voluntary* cession of title. Thus it has been held that a transfer in lieu of foreclosure (*Rogers* v. *Commissioner,* 103 F. (2d) 790, C. C. A. 9, cer. den. 308 U. S.

580; *Wieboldt* v. *Commissioner,* 113 F. (2d) 384,[5] C. C. A. 7), or even under threat of foreclosure (*Pender* v. *Commissioner,* 110 F. (2d) 477, C. C. A. 4; *Philips* v. *Commissioner,* 112 F. (2d) 721, C. C. A. 3), in consideration of a cancellation the indebtedness, constitutes a sale.

The sense of these rulings is indicated by the following excerpt from the opinion in the *Philips* case, *supra*:

> "We think that the Board of Tax Appeals properly held the transaction to be a sale or exchange. In *Commissioner* v. *Freihofer,* 3 Cir., 102 F. (2d) 787, 125 A. L. R. 761, this court held that the words 'sale' and 'exchange' as used in Section 117 connote voluntary action by the owner and a consideration. In the present case the petitioner's conveyance was voluntary. Even though it was made under threat of foreclosure, the petitioner had a choice and his exercise of this choice was his voluntary act. *Pender* v. *Commissioner,* 4 Cir., 110 F. (2d) 477. Likewise he received a valuable consideration, relief from his personal liability to pay three years taxes. The elements of a sale were thus present."

---

[5] In that case the court noted the conflict between the *Freihofer* and *Hammel* cases and the instant case, and, after observing that "the conflict between the three decisions will no doubt be resolved by the Supreme Court which has granted certiorari in the *Electro-Chemical* case * * *" said:

> "We consider it significant, however, that in two other cases involving the question presented by the case at bar, of the applicability of the section to *voluntary* transfers to avoid foreclosure proceedings, *Rogers* v. *Commissioner,* 9 Cir., 103 F. (2d) 790, and *Pender* v. *Commissioner,* 4 Cir., 110 F. (2) 477, the Supreme Court has denied certiorari (October 9, 1939, *Rogers* v. *Commissioner,* 308 U. S. 580, 60 S. Ct. 98, 84 L. Ed.—, and June 3, 1940, *Pender* v. *Commissioner,* 60 S. Ct. 1103, 84 L. Ed.—). It is fair to infer from this action that the Court found no conflict between these decisions and those involving involuntary sales."

In the case at bar the learned Circuit Court flatly rejected the test applied in the foregoing cases, saying: "Between a situation adjusted by cancellation of the mortgage notes in return for a 'voluntary' deed of the land, when the adjustment is made with knowledge of the possible resort to foreclosure, and a situation where foreclosure is actually resorted to, there would seem to be little difference" (110 F. (2d) at p. 616). Indeed, as the decision below attests, the opposing situations presented no point of difference whatever to the mind of the Court. The best answer to this sweeping assertion may be made in the language of respondent, in opposition to the application for *certiorari* in the *Rogers* case, *supra*:

> "Petitioners insist that the transfer was made in lieu of foreclosure and that the transaction must, therefore, be considered in the same light as foreclosure. *But this would have been a wholly different transaction,*[6] both involuntarily

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[6] This view, asserted for the purpose of defeating certiorari in the *Rogers* case, was abandoned by the Commissioner after the denial of certiorari. Compare the quoted statement with the following language of the Commissioner's brief (pp. 17-18) in the Circuit Court, in the instant case:

> "The only distinction between that (*Rogers*) case and this is that the sale here was not made by the taxpayer, *a distinction which we will show to be of no significance.*"

Shortly thereafter, however, the distinction was revived by the Commissioner, in opposing a review of the *Pender* case:

> "*The question in the Electro-Chemical, Hammel and Freihofer cases is plainly different from the question here. This was not an involuntary foreclosure sale of the mortgaged premises ordered by the court and involving the risk of a deficiency judgment;* it was rather a *voluntary* transfer made by the petitioners, not only of the mortgaged property but also of other unencumbered property owned by them. *The petitioners contracted for and consented to the transfer and they received the consideration for the transfer.* The transfer must, therefore, be regarded as a sale, irrespective of the conclusion which the Court may ultimately reach in the *Hammel* case" (Respondent's Brief, p. 8, in Opposition to Petition for Certiorari, in *Pender* v. *Commissioner*). (Italics ours.)

> on the part of petitioners and involving the risk of a deficiency judgment" (Commissioner's Brief, (p. 9), in opposition to petition for certiorari in *Rogers* v. *Commissioner;* cer. den. 308 U. S. 580).

It should be noted, moreover, that, at page 8 of the brief just referred to, the Commissioner—who now insists that the *Freihofer* case, *supra,* was wrong—did not even intimate a doubt as to the correctness of that decision, but, on the contrary, apparently accepted the test applied in the *Freihofer* case, by arguing that that case "obviously has no application to and is not in conflict with the present (*Rogers*) case, *since the transfer here resulted from the voluntary action of the decedent and his wife,* for which they received a valuable consideration". (Italics ours.)

V.

We have already noted that the court below rejected the notion that the question of the applicability of Sec. 117 (d) could turn upon the circumstance of the voluntary or involuntary character of a particular "sale". It sought to fortify its view by the following analogy:

> "We should be surprised if a taxpayer who had pledged securities with a broker and had them sold out on the Stock Exchange could obtain a deduction of more than $2000 for a capital loss incurred through such a liquidation. If the sale were made at the pledgor's request it could not be doubted that 117 (d) would apply and that no loss in excess of $2,000 could be deducted for

> income tax purposes. *Rogers* v. *Commissioner*, 103 F. (2d) 790 (C. C. A. 9). Likewise, if the customer realized a gain through such a liquidation he would be entitled to limit his taxable gain in computing net income to the percentages provided by Section 117 (a). It cannot be supposed that it would make any difference whether a pledgee ordered or merely suffered his securities to be sold by his broker, and we think that in either event he could limit his taxable gain by the percentages under Section 117 (a) and could take a deduction of only $2,000 for any loss that he might suffer. We see no valid distinction between a sale by a broker who holds his customer's securities and a sale of mortgaged real estate by means of a decree in foreclosure" (fol. 69).

This attempted analogy, we submit, proceeds upon an erroneous premise, *i. e.*, that the sale of securities pledged with a broker is an *involuntary* sale. Ordinarily, the exact contrary is the case. It is common knowledge that the conventional margin account is subject to a written margin agreement, which authorizes the broker to sell pledged securities *for the account of the customer*. A sale of securities so pledged is therefore a *voluntary* sale, made by a duly authorized agent, pursuant to a power expressly conferred.

A fundamentally different situation is presented by this record. There was no power of sale in the mortgage. There was no sale by the petitioner; there was none by the mortgagee, in petitioner's behalf. What occurred was a judicial sale, *in invitum*, to implement the decreed forfeiture of petitioner's estate.

Neither in fact, nor in theory, was the referee who conducted the sale the agent of petitioner (*Pewabic Mining Co.* v. *Mason,* 145 U. S. 349, 361-2; *Mitchell* v. *Bartlett,* 51 N. Y. 447, 452). He was the "representative of the court" (*Pewabic Mining Co.* v. *Mason, supra*), deriving his powers not from a contractual grant of authority, but from a judicial commission. To attribute to the execution of this commission the legal equivalence of a sale by private warrant is to ignore both legal principle and economic reality.

VI.

The court below perceived a threat to the national revenue in the acceptance of the proposition that the $2000 limitation was inapplicable to an involuntary disposition of a capital asset. It noted its concern in the following language:

> "If capital losses were limited to $2,000 only in case of voluntary sales a taxpayer could frequently secure the benefit of an ordinary loss deduction through liquidation of pledged or mortgaged property by a friendly broker or mortgagee. It seems to us quite unlikely that the national revenue can be affected by such distinctions or by the accident of who causes the sale to be made" (fol. 70).

The Commissioner has stipulated that in the instant case the foreclosure was a real one, the petitioner's loss an actual one, and its computation a correct one. To say to an honest taxpayer that he is denied the benefits of a plain provision of the Revenue Act because the Act is susceptible of fraudulent misuse by a dishonest taxpayer, is indeed a startling and

novel judicial utterance. There is ample provision in the federal criminal laws and, indeed, in the very Revenue Act of 1934 (secs. 145 and 293 (b)), to safeguard the public interest against fraudulent tax evasion. It is not the function of courts to plug assumed holes in the Revenue Act, by judicial legislation. "Laws enacted with good intention, when put to the test, frequently, and to the surprise of the lawmaker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the law making authority, and not with the court" (*Crooks* v. *Harrelson,* 282 U. S. 55, 60). Certainly, if every tax statute were construed in the light of what a dishonest taxpayer might do through collusion, fraud or evasion, an honest taxpayer would never have his rights adjudicated on the *real* facts of his particular case. However, the concern of the Second Circuit is academic; the question can no longer arise, for, since the Revenue Act of 1938, property such as is here involved is no longer within the classification of a "capital asset".

POINT TWO.

The foreclosure sale was not the identifiable event establishing petitioner's loss.

Since the mortgage contained no power of sale (cf. Real Property Law (N. Y.) Art. 17, Sec. 540 *et seq.*) the instant foreclosure necessarily took the form of a judicial foreclosure (Civil Practice Act (N. Y.) Art. 65, Sec. 1077 *et seq.*). Generally speaking, foreclosure actions under the Civil Practice Act follow the traditional pattern of such suits, save, perhaps, for an enlightened and realistic deficiency judgment procedure. The judgment pronounces the foreclosure,

i. e., the forfeiture of estate.[7] In a very real sense the judgment, with its declared consequence of the extinguishment of title or equity of redemption, not only is the identifiable, but the precisely *identified*, event from which the loss naturally flows.

But the judgment is obviously not self-executing. To "enforce the judgment" (*Morris* v. *Morange*, 38 N. Y. 172, 174) a referee must sell the property, in obedience to the court's command. That, however, is not the identifiable event by which either the *factum* or the *quantum* of the loss is established. The sale is an incidental and "purely ministerial" act (*Morris* v. *Morange, supra*). It is but a link in the chain of the foreclosure proceedings, a step in the action itself. It is a part of the whole and has no independent status or significance.

"The *foreclosure* was the identifiable event which established (petitioner's) loss" (*Commissioner* v. *Hammel, supra*); but the foreclosure must be viewed as an integrated whole, as a judicial process, proceeding step by step, and achieving its ultimate legal effect from the sum of all its parts.

In this view there can be no rational selection of a particular part as the "specific" or "identifiable" event establishing the loss, without the distortion of essential values. But even were this not so, the foreclosure sale could still not be said to be the event establishing the loss. The judgment, respon-

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7. "ORDERED, ADJUDGED AND DECREED that both of said defendants in this action * * * be and they hereby are forever barred and foreclosed of all right, title and interest, claim, lien and equity of redemption in said mortgaged premises or any part thereof * * *" (R., pp. 33-34).

sively to the statute, contained the following provision:

> "ORDERED, ADJUDGED AND DECREED that the plaintiff may apply at the foot of this judgment *after* a sale thereunder, pursuant to Sec. 1083(a) of the Civil Practice Act for judgment herein against the defendant Electro-Chemical Engraving Company, Inc. for such deficiency, if any, as the court shall deem the plaintiff entitled to * * *" (R., pp. 32-33).

Until the expiration of "ninety days after the date of the consummation of the sale by the delivery of the proper deed of conveyance to the purchaser * * *" (C. P. A., Sec. 1083 (a)), petitioner did not and could not know whether a motion for a deficiency against it would be made and if made, granted; and if granted, to what extent. Until then petitioner could not know what the amount of the ultimate judgment against it would be; and, while no deficiency was in fact applied for, petitioner did not and could not know the exact amount of its loss until at least after the ninety days had elapsed.

The ultimate fixation and determination of petitioner's actual loss was contingent upon the final outcome of the foreclosure litigation. It was not and could not be determined by the judgment; it was not and could not be determined by the "sale" conducted by the Referee; and it was not and could not be determined by the Referee's deed of conveyance. It became fixed with precision and finality, only when the period within which the mortgagee could have invoked the deficiency judgment procedure, was at an end (cf. *Commissioner* v. *Hawkins,* 91 F. (2d) 354,

C. C. A., 5, where it was held that a loss due to a foreclosure occurred at the end of the period of redemption and not when the foreclosure sale took place).

CONCLUSION.

The judgment of the Circuit Court should be reversed.

Respectfully submitted,

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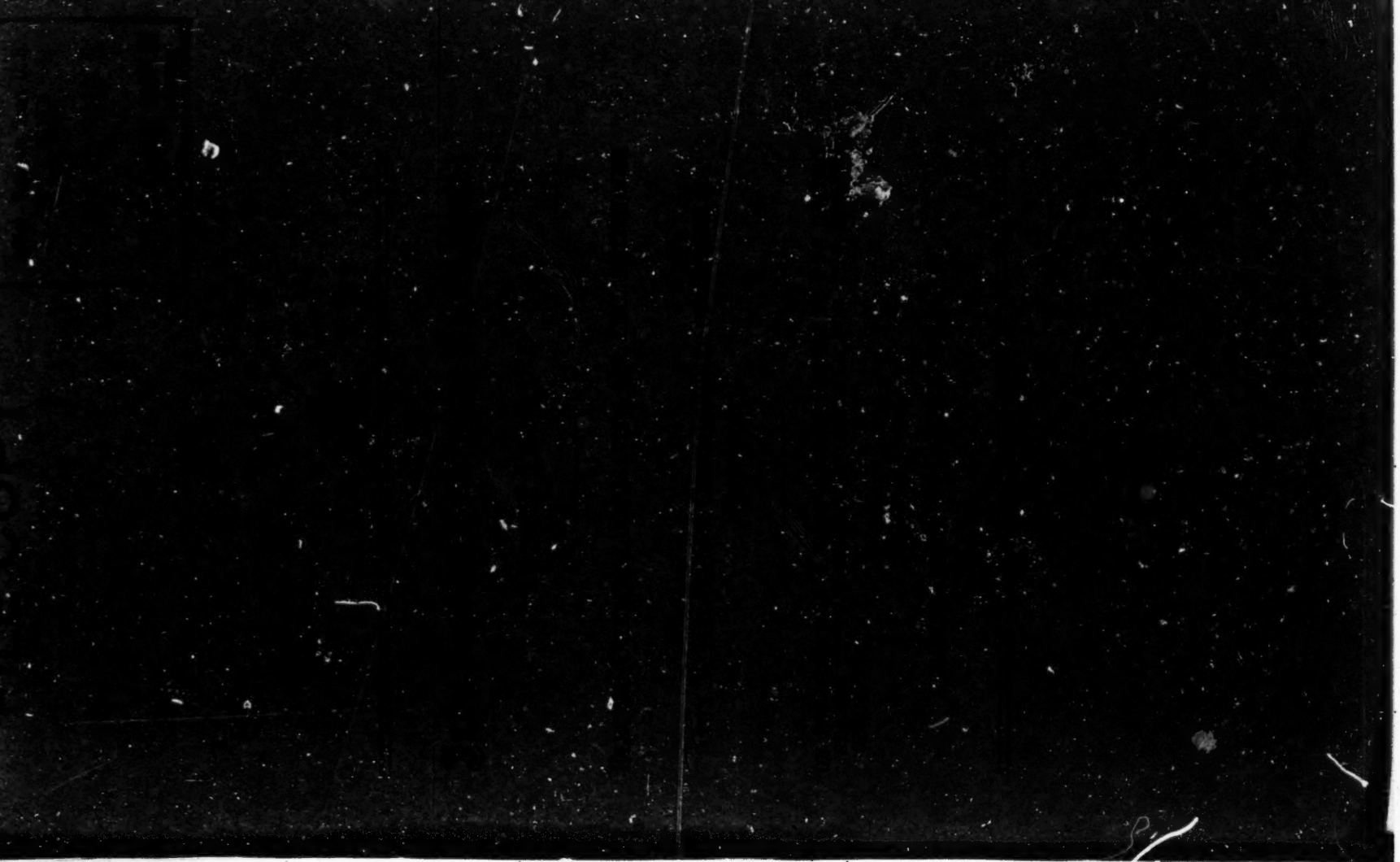

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In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 962

ELECTRO-CHEMICAL ENGRAVING CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

We do not oppose the granting of a writ of certiorari in this case.

There is now pending in this Court the Government's petition for a writ of certiorari (No. 895) to the Circuit Court of Appeals for the Sixth Circuit in *Commissioner* v. *Hammel,* 108 F. (2d) 753, in which a conflict with the instant case is asserted. While we think the decision of the court below is correct, we do not oppose the granting of the writ in view of the conflict and because it is important in

the administration of the revenue laws that the question be settled.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.

MAY 1940

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v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 18–20) is unreported. The opinion of the Circuit Court of Appeals (R. 39–43) is reported in 110 F. (2d) 614.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 3, 1940 (R. 43–44). The petition for certiorari was filed May 1, 1940, and granted June 3, 1940. The jurisdiction of this Court is

conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer purchased real estate and gave a purchase money mortgage. Upon default the property was sold at foreclosure. The question presented is whether the resulting loss was a capital loss subject to the limitations on deductibility contained in Section 117 of the Revenue Act of 1934. The answer to this question depends upon whether the foreclosure sale constituted a "sale" or "exchange" within the meaning of Section 117 (d).

STATUTE INVOLVED

The statutory provisions involved are identical with those contained in Appendix A to the Government's brief in *Helvering* v. *Hammel*, No. 49, present Term, except that instead of Section 23 (e) of the Revenue Act of 1934, entitled "Losses by Individuals," Section 23 (f) is pertinent here. It provides:

> (f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

STATEMENT

The facts, as stipulated (R. 32–36), may be stated as follows:

The taxpayer, a New York corporation, in 1927 purchased for factory use improved real property

located in Queens County, New York, for a total price of $150,000. The terms of the sale provided for a $50,000 down payment, the assumption of a $20,000 first mortgage indebtedness and the execution of an $80,000 purchase money second mortgage. (R. 32–33.) Subsequently, the first mortgage was discharged and thereafter petitioner defaulted in making the payments due under the purchase money mortgage. (R. 33.) In December, 1934, the assignee of the purchase money mortgage brought a foreclosure action in the New York Supreme Court in Queens County. (R. 33.) On February 6, 1935, the holder of the mortgage obtained a judgment against the taxpayer for $50,594.72 (consisting of $40,000 unpaid principal, $2,100 interest, and $8,494.72 unpaid real estate taxes and penalties), ordering a foreclosure sale. (R. 34.) Pursuant to such judgment, the mortgaged premises were sold by a referee appointed by the court on March 7, 1935, for the sum of $21,000. The purchaser was not the holder of the mortgage. On March 22, 1935, the referee executed a deed of conveyance to the purchaser. (R. 34.)

Of the price realized at the sale $20,166.39 was applied by the referee toward the debt of $50,594.72, leaving a deficiency of $30,428.33. (R. 34.) The holder of the mortgage has not sought to enforce the deficiency against the taxpayer under Section 1083–a of the New York Civil Practice Act.

(R. 34–35.)[1] After the taxpayer's basis is adjusted for capital expenditures and depreciation allowed its loss amounted to $100,771.38. (R. 19–20, 35–36.)

The Board of Tax Appeals held that ordinary income (in excess of $100,000, R. 11) received by the taxpayer in 1935 should be reduced by the full amount of this loss, rejecting the Commissioner's

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[1] That section provides in part as follows:

"No judgment shall be granted for any residue of the debt remaining unsatisfied as prescribed by the preceding section where an action to foreclose the mortgage has been or shall be commenced during the emergency or where the mortgaged property shall be sold during the emergency, except as herein provided. Simultaneously with the making of a motion for an order confirming the sale, provided such motion is made within ninety days after the date of the consummation of the sale by the delivery of the proper deed of conveyance to the purchaser in all cases where the sale is held after the date this section as hereby amended takes effect, and in all cases where the sale was held prior to the date this section as hereby amended takes effect and said sale has not heretofore been confirmed, then within ninety days from the date this section as hereby amended takes effect or within ninety days after the date of the consummation of the sale by delivery of the proper deed of conveyance to the purchaser, regardless of whether the sale was held prior or subsequent to or on the date this section as hereby amended takes effect, the party to whom such residue shall be owing may make a motion in the action for leave to enter a deficiency judgment upon notice to the party against whom such judgment is sought or the attorney who shall have appeared for such party in such action. Such notice shall be served personally or in such other manner as the court may direct. Upon such motion the court, whether or not the respondent appears, shall determine, upon affidavit or otherwise as it shall direct, the fair and reasonable market value of the mortgaged premises as of the date such prem-

contention that only $2,000 of the loss was deductible under Section 117 (d) of the Revenue Act of 1934. The Circuit Court of Appeals reversed the Board's decision.

ARGUMENT

The Government's brief in No. 49, *Helvering* v. *Hammel*, states the Government's position with respect to a set of facts similar to those at bar and the interpretation of the same controlling statutory provisions. We respectfully refer the Court to that brief, which we incorporate by reference herein. In the *Hammel* case, the taxpayer suffered loss when a contract under which she (and others) had purchased land was foreclosed, and the property sold. We have argued in our brief in that case that a foreclosure sale is a "sale" as the word is ordinarily understood, and that the loss clearly resulted from such sale since it deprived the tax-

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ises were bid in at auction or such nearest earlier date as there shall have been any market value thereof and shall make an order directing the entry of a deficiency judgment. Such deficiency judgment shall be for an amount equal to the sum of the amount owing by the party liable as determined by the judgment with interest, plus the amount owing on all prior liens and encumbrances with interest, plus costs and disbursements of the action including the referee's fee and disbursements, less the market value as determined by the court or the sale price of the property whichever shall be the higher. If no motion for a deficiency judgment shall be made as herein prescribed the proceeds of the sale regardless of amount shall be deemed to be in full satisfaction of the mortgage debt and no right to recover any deficiency in any action or proceeding shall exist."

payer of her beneficial ownership of the property. To the argument that Section 117 of the Revenue Act of 1934 does not apply to a forced sale, we pointed out that no such limitation is suggested by the language of the statute, its legislative history, or what may be presumed to have been the congressional purpose.[2] On the other hand, there is clear indication that the words "sales or exchanges" were used in a broad sense, and specifically, that involuntary transactions were intended to be included.

The slight variations between the facts in the *Hammel* case and those in the case at bar are not believed to be of significance. While Electro-Chemical Engraving Company was a mortgagor, whereas Pearl Hammel was vendee under a land contract, both taxpayers possessed the same type of capital asset, namely, the beneficial ownership of real property subject to a security interest. It is true, however, that the taxpayer in the instant case had legal title as well as beneficial ownership; the mortgagee had only a lien. *Becker* v. *McCrea*,

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[2] House Report No. 1388, 67th Congress, 4th Session, from which the taxpayer quotes (Br. 9–10) has reference to a bill (H. R. 13770) which was not enacted into law. The report is of little aid in arriving at the intent of the subsequent Congress which enacted the first capital loss provisions in the Revenue Act of 1924. In any event, the report does not indicate an intention to limit the proposed legislation to voluntary sales by the taxpayer. In fact it states (p. 5) that "The general purpose of the proposed measure is to increase the revenue by limiting deductions."

193 N. Y. 423, 86 N. E. 463; *Barson* v. *Mulligan*, 191 N. Y. 306, 84 N. E. 75.

In the instant case the mortgagee did not take the necessary steps to secure a deficiency judgment. Consequently the taxpayer apparently escaped additional loss which could have been expected to accrue from the transaction, just as Pearl Hammel escaped part of her loss by going through bankruptcy instead of paying the deficiency judgment. The effect of what occurred in the instant case was that the taxpayer was relieved of a mortgage obligation in consideration of the transfer of the property. Thus, in substance, the taxpayer is in the same position as were the taxpayers in *Rogers* v. *Commissioner*, 103 F. (2d) 790 (C. C. A. 9th), certiorari denied, 308 U. S. 580; *Pender* v. *Commissioner*, 110 F. (2d) 477 (C. C. A. 4th), certiorari denied, 310 U. S. 650, and *Wieboldt* v. *Commissioner*, 113 F. (2d) 384 (C. C. A. 7th). In each of those cases the taxpayer voluntarily relinquished the property to the mortgagee in consideration of cancellation of the mortgage debt. The important fact is that in the instant case, as well as in the *Hammel* case, it was the foreclosure sale that deprived the taxpayer of beneficial ownership, and passed it on to a new owner. Thus in each case the taxpayer's loss resulted "from" the "sale."

The taxpayer's contention (Br. 6–9) that a foreclosure sale is not a "sale" within the ordinary meaning of the word is without merit. Certainly

there was a purchase of the property and if a purchase there must have been a sale. Cf. *Butler* v. *Thomson*, 92 U. S. 412, 416. In fact, it is difficult to describe the transaction without the use of the word "sale". Compare *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216. The contention fails to recognize that in our legal system it is common for an owner to lose his property by a judicial sale conducted for the primary benefit of his creditors and without his participation. Legal and other dictionaries include forced or judicial sales under the general definition of the word equally with voluntary sales. See Funk & Wagnalls New Standard Dictionary (1937 Ed.), Vol. II, p. 2162; Black's Law Dictionary (3d Ed.), p. 1578; Bouvier's Law Dictionary, Third Revision, Vol. 2, p. 2984. The ordinary definition of the word adopted by this Court in the *Five Per Cent. Cases*, 110 U. S. 471, is clearly broad enough to include an involuntary sale. There this Court stated (p. 478) that "A sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent." The taxpayer's argument represents an attempt to narrow or limit the ordinary meaning of the term to a particular type of sale—that is, a sale carried out directly by a taxpayer. This construction is justified by neither the language nor the intent of the legislature.

The taxpayer is also in error in contending (Br. 20–23) that the foreclosure sale was not the identi-

fiable event which established its loss. On the contrary that was the necessary event which not only deprived the taxpayer of its property, but also determined whether a loss was sustained, and in the present case the exact amount. The judgment itself did not deprive the taxpayer of its interest in the property. Until the sale and the delivery of the referee's deed pursuant thereto it retained the right of possession and user. *Mitchell* v. *Bartlett*, 51 N. Y. 447; *Central Hanover Bank & Trust Co.* v. *Boccia*, 244 N. Y. App. Div. 106, 112. Furthermore, until the sale the taxpayer continued to possess its interest in the property and its right to redeem and thus prevent the loss of its property. *Nutt* v. *Cuming*, 155 N. Y. 309. The recital in the judgment purporting to bar the defendants' interest and equity of redemption, adverted to by the taxpayer (Br. 21), must be read in connection with the judgment as a whole, particularly the portion thereof ordering the sale of the premises (R. 31–32). When so read it will appear that the sale and not the judgment bars those rights. Cf. Section 1085, New York Civil Practice Act; *Nutt* v. *Cuming*, *supra*; *Sichler* v. *Look*, 93 Cal. 600, 609–611.

The sale also determined whether the taxpayer sustained a loss with respect to its investment and in this case the exact amount of the loss. This it did by establishing the amount realized by the taxpayer from the property which was applied against

its obligation. The determination of the amount realized for the property is a necessary element in determining the amount of the loss. See Revenue Act of 1934, Section 111 (a), which is quoted in Appendix A to the Government's brief in the *Hammel* case. It is true that the amount of the loss from the transaction might later be increased if within the time provided by law (see Section 1083–a, New York Civil Practice Act, *supra*) the mortgage creditor should move for and thereafter procure a deficiency judgment and the taxpayer should pay the amount and thus increase its cost basis for the property. Even that additional loss relates back to the sale, since Section 1083–a of the New York Civil Practice Act provides that the amount derived at the sale, or the market value at that time if greater, shall measure the deficiency. But no such additional loss occurred or is claimed in the present case, and it is quite clear that the sale here was the event which determined that the taxpayer's deductible loss occurred and measured the amount by establishing the amount realized by it from the property.

We submit that the taxpayer's loss in the present case was from the foreclosure sale, which was a sale of a capital asset within the legislative language and intent and that accordingly the court below correctly held that the deductible loss was limited to the amount of $2,000 by reason of the provisions of Section 117 (d) of the Revenue Act of 1934.

CONCLUSION

The decision of the Circuit Court of Appeals should be affirmed.

Respectfully submitted.

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SAMUEL O. CLARK, JR.,
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SEWALL KEY,
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NOVEMBER 1940.

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SUPREME COURT OF THE UNITED STATES.

No. 62.—October Term, 1940.

Electro-Chemical Engraving Co., Inc., Petitioner, *vs.* Commissioner of Internal Revenue. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 6, 1941.]

Mr. Justice Stone delivered the opinion of the Court.

This is a companion case to No. 49, *Helvering* v. *Hammel*, decided this day.

The question is whether the loss suffered by petitioner on foreclosure sale of his mortgaged property, acquired for profit, may be deducted in full from gross income or only to the extent provided by § 117(d) of the 1934 Revenue Act. The statutory provisions involved are those of the 1934 Act relating to capital gains or losses, particularly "losses from sales or exchanges of capital assets" considered in the *Hammel* case which are made applicable to petitioner, a corporation, by § 23(f)(j).

The Board of Tax Appeals ruled that petitioner's loss was deductible in full from its ordinary income. The court of appeals for the second circuit reversed the Board, 110 F. (2d) 614, holding that the loss sustained by petitioner was a loss from a sale of capital assets, § 23(j), which under § 117(d) could be deducted from the gross income only to the extent of capital gains, plus $2,000. We granted certiorari, 310 U. S. 622, so that the case might be considered with the conflicting decision of the court of appeals for the sixth circuit in the *Hammel* case, 108 F. (2d) 753. For the reasons stated in our opinion in the *Hammel* case we think that this case was rightly decided below.

Affirmed.

Mr. Justice Roberts dissents.